S. HRG. 108–877

OVERSIGHT OF THE TERRORISM RISK INSURANCE PROGRAM

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

ON

THE TERRORISM RISK INSURANCE PROGRAM, WHICH ESTABLISHED A TEMPORARY FEDERAL PROGRAM OF SHARED PUBLIC AND PRIVATE COMPENSATION FOR INSURED COMMERCIAL PROPERTY AND CASUALTY LOSSES RESULTING FROM ACTS OF TERRORISM COVERED BY THE TERRORISM RISK INSURANCE ACT

MAY 18, 2004

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

Available at: http://www.access.gpo.gov/congress/senate/senate05sh.html

U.S. GOVERNMENT PRINTING OFFICE

24–851 PDF WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

RICHARD C. SHELBY, Alabama, *Chairman*

ROBERT F. BENNETT, Utah
WAYNE ALLARD, Colorado
MICHAEL B. ENZI, Wyoming
CHUCK HAGEL, Nebraska
RICK SANTORUM, Pennsylvania
JIM BUNNING, Kentucky
MIKE CRAPO, Idaho
JOHN E. SUNUNU, New Hampshire
ELIZABETH DOLE, North Carolina
LINCOLN D. CHAFEE, Rhode Island

PAUL S. SARBANES, Maryland
CHRISTOPHER J. DODD, Connecticut
TIM JOHNSON, South Dakota
JACK REED, Rhode Island
CHARLES E. SCHUMER, New York
EVAN BAYH, Indiana
ZELL MILLER, Georgia
THOMAS R. CARPER, Delaware
DEBBIE STABENOW, Michigan
JON S. CORZINE, New Jersey

KATHLEEN L. CASEY, *Staff Director and Counsel*
STEVEN B. HARRIS, *Democratic Staff Director and Chief Counsel*
DOUG NAPPI, CHIEF COUNSEL
MARK F. OESTERLE, *Counsel*
SARAH A. KLINE, *Democratic Counsel*
JOSEPH R. KOLINSKI, *Chief Clerk and Computer Systems Administrator*
GEORGE E. WHITTLE, *Editor*

C O N T E N T S

TUESDAY, MAY 18, 2004

WITNESSES

OVERSIGHT OF THE TERRORISM RISK INSURANCE PROGRAM

TUESDAY, MAY 18, 2004

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:03 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order. I would like to thank our panelists for being here this morning.

Today, we are here to examine the Terrorism Risk Insurance Program. This program was put in place after the horrible events of September 11, 2001. Clearly, when we think of the events of September 11, we first think of the tragic and staggering loss of human life that occurred that day.

While secondary to the human suffering, there was also considerable destruction of physical and financial assets. In the immediate aftermath, most of these losses were covered by the insurance industry. However, the insurance market had difficulty recovering and adjusting to the realities of the post-September 11 world. Many firms had depleted their reserves in meeting their significant liabilities. Going forward, the industry had to confront the difficulty of recapitalizing in the face of future terrorist acts. The lack of certainty caused significant dislocations to the insurance markets—most notably, due to the disappearance of reinsurance coverage. These problems, as policyholders soon became aware throughout the country, had a direct impact on both the cost and availability of insurance.

The TRIA Program, which created a backstop using the resources of the Federal Government, was established to stabilize the insurance markets. It was meant to be a short-term fix, intended to fill the gap while the private sector developed response to the potential loss from the terror attacks. The program is now in the second year of its 3-year term. While our discussions about the operation of the program can only be hypothetical, and hopefully will always only be hypothetical, it is a very important part of our oversight responsibilities to discuss and to examine it before we may ever need to rely on it.

I look forward to hearing from the witnesses, and I thank all of you for being here today.

Senator Johnson, do you have an opening statement?

STATEMENT OF SENATOR TIM JOHNSON

Senator JOHNSON. Yes, I do. Thank you, Chairman Shelby. I appreciate your work and Ranking Member Sarbanes' efforts for holding today's hearing on terrorism risk insurance. I am sure we all share the same feeling of relief since we passed the Terrorism Risk Insurance Act of 2002 following September 11 that, in fact, no events have triggered the use of this Federal backstop. However, world events require us to remain vigilant against the possibility of another major attack. I am pleased that we are directing our attention to this program in advance of its expiration next year. This is a complicated topic, and I look forward to hearing from the witnesses about marketplace developments that may or may not have taken place to help us consider reauthorization of this program.

I am pleased, Mr. Chairman, at the range of witnesses before us today. When we first considered this program more than 2 years ago, then-Chairman Phil Gramm did not mince words expressing his concern that we not create a permanent Federal program that would provide a crutch to the insurance industry and prevent the market from developing independently. While I do not believe that we have reached that point, I do believe that we should proceed deliberately and gather data from both industry and non-industry sources to see if reauthorization is really necessary. At the end of the day, this program is not about the profits of the insurance industry. It is about the ability of American businesses to have access to insurance protection. And for that reason, I believe that any extension of this program should include "make-available" provisions. That should be the very minimum required of an industry that enjoys this type of protection that we have provided.

As we begin our deliberations, Mr. Chairman, I want to state at the outset that I believe very strongly that if we extend this program, group life should be part of that extension. Two years ago, I worked to include group life insurance in the Terrorism Risk Insurance Program. I was disappointed that the Bush Administration chose to focus its efforts on insuring buildings against terrorism, but was dismissive of the critical role that group life insurance plays for tens of thousands of families at the highest risk of terrorist attack.

We saw vividly post-September 11 the sufferings of so many families. And while the most immediate grieving was for the loss of human life, the harsh reality is that many families lost their livelihood as well. In a time of loss, a life insurance policy can mean the difference between having to sell the family home, pulling the kids out of college, or even, in some cases, having enough money to put food on the table. It is critical that we create conditions that permit the private insurance markets to continue to offer group life insurance coverage to employees at high risk of attack.

Since we implemented the Terrorism Risk Insurance Program, one of the most apparent market shifts has been the near-complete disappearance of affordable reinsurance for group life policies. Although insurers have continued to offer this valuable coverage up to this point, even for high-risk concentration locations, we should pay careful attention to potential solvency issues that could arise in the case of another major attack.

I look forward to hearing from today's witnesses.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Bennett.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman.

I recall very clearly the effort to get this program in place after September 11 and the great frustration that I felt when, for a variety of reasons, there was continuing delay in getting it done. I had the feeling then, which I still believe, that failure to get this done prolonged the recession and had a contributory effect on the softness of the recovery because a lot of projects that would have been undertaken had terrorism insurance been in place were delayed. And I think, as the recovery now has traction and is coming on very strong, we would make a serious mistake if we allowed this program to expire. We would have significant economic difficulties as a result.

I appreciate the hearings, and I look forward to hearing from the witnesses.

Chairman SHELBY. Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. No statement, Mr. Chairman. I have come to observe and possibly ask questions. Thank you.

Chairman SHELBY. Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Thank you, Mr. Chairman. I want to thank you for holding this hearing. Many of us were on the Committee when we enacted the Terrorism Risk Insurance Act, and I appreciate the opportunity to revisit the program to review its implementation.

I reluctantly supported the legislation passed in 2002. I believe in free markets, and, thus, I am loath to inject the Federal Government into private markets. I became convinced that the events of September 11, 2001, were indeed an extraordinary event that required a temporary backstop in order to give the markets time to adjust. And I emphasize the word "temporary" here.

I came around to supporting the TRIA legislation only after repeated assurances from the industry that this was a one-time thing, simply buying time for the private markets to regroup.

I do not believe there is an ambiguity as to the Congressional intent that the program should be temporary. In fact, in the conference report, the purpose section begins this way, and I quote directly out of that section: "The purpose of this title is to establish a temporary Federal program that provides for a transparent system of shared public and private compensation for insured losses resulting from acts of terrorism."

Now the industry is back with the same arguments. Once again we are being told that the markets just need a little more time to adjust. I am not sure why we should believe it this time, though. If this is to become a perpetual Government program, like flood insurance, the industry should be honest about it. Then we could have a legitimate debate about the role of the Federal Government in the insurance industry rather than threats of market chaos every few years.

I will be following today's hearing carefully, and I will be interested in hearing what progress industry has made once again letting the free market take control.

Again, Mr. Chairman, thank you for convening the hearing. I look forward to hearing about this topic.

Chairman SHELBY. Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Mr. Chairman, I want to thank you for calling the hearing. We are now a little short of halfway through the life of the Terrorism Risk Insurance Program, and oversight to determine how the program is working is very important.

The Terrorism Risk Insurance Act came out of the work of this Committee, as a consequence of the September 11 attacks. It sought to establish a temporary Federal program with two purposes: The first was to ensure continued widespread availability of affordable property and casualty insurance for terrorism risk; the second was to create a transitional period, while preserving State insurance regulation and consumer protections, in which the private insurance markets could stabilize in the wake of the shock of September 11, resume pricing terrorism insurance, and build the capacity to absorb any future losses from acts of terrorism.

The Department of the Treasury has the responsibility to implement the Terrorism Risk Insurance Program. That is, I guess, Secretary Roseboro, that is under your jurisdiction now. The Treasury has the obligation to gather information in a timely and effective manner about terrorism insurance coverage and pricing. It must use that information to make a series of determinations and recommendations under the statute.

The most immediate determination is whether to extend to the program's third year the requirement that insurers make terrorism coverage "available" to property and casualty policyholders. And I welcome Under Secretary Roseboro here in order to discuss that and other issues.

Mr. Chairman, I am going to have to go to another hearing, and I intend to return, but I do want to register—and presumably Secretary Roseboro will address this issue, the "make-available" decision given to the Treasury Department for the third year of the program. The Senate bill had "make-available" for the life of the program, all 3 years, when we first moved the legislation. In the course of the legislative process, including interaction with the House and with the Administration, it was provided that "make-available" was in the statute for 2 years, but the Treasury had the authority to "make-available" the third year.

That decision has to be made by September 1. From all we have heard, that is a very late date because it affects planning and availability and there is considerable concern, apparently, in the private sector with respect to that date.

I am concerned that the Treasury Department waited until April 29 to publish a request for comments on the "make-available" question. In a sense, we believe the Treasury Department is behind the curve here on that very important issue. I know you have received communications from our colleagues in the House about this matter, and it is the immediate issue facing us. And I think we need a prompt decision and recommendation from Treasury. You have the authority to proceed into the third year. It was given to you by the statute.

I also appreciate, Mr. Chairman, the second panel that you have arranged. It is a wide-ranging panel in terms of its points of view, and I think that will be very much to the benefit of the Committee.

Finally, I would be remiss, Mr. Chairman, if I did not note the leadership that Senator Dodd exercised on this issue when it was being considered in the Committee, on the Floor, and in Conference. And I believe it is fair to say that, without his efforts, the Terrorism Risk Insurance Act of 2002 would not have become law, and I want to register my deep appreciation to him for his very effective work on this issue.

Thank you very much.

Chairman SHELBY. Senator Bunning.

STATEMENT OF SENATOR JIM BUNNING

Senator BUNNING. Thank you, Mr. Chairman, for holding this very important oversight hearing today. I supported the Terrorism Risk Insurance Act when this Committee worked on it in the aftermath of September 11. It took us a long time to get the bill signed into law, too long if you ask me. But dogged determination by a majority of the Members of this Committee got the bill passed. I think our economy has been aided by this passage.

I know some of my colleagues had real reservations about the bill. And I certainly understand why. Luckily, we have not been hit by another major domestic attack to see if this program actually works the way it was intended to after an attack. I think it has worked well absent an attack. Stability has been brought to the industry, and construction projects are going forward. Hopefully, we will never have to see if this program works after a major domestic attack.

But I do believe it is very proper to reexamine the Terrorism Risk Insurance Act, especially with the "make-available" provisions, as Senator Sarbanes has talked about, set to expire later this year and the bill expiring next year. It is time to see when and where we can improve this program, and what we can do to get the reinsurance industry back into the game.

I am very happy to hear from all of our witnesses today. I am especially interested in, as I am sure all of my colleagues are and I suspect most of our witnesses, what Treasury has to say about "make-available" provisions that expire at the end of this summer. I know Treasury's comment period ends on June 4. I would like to know if Treasury has an idea or timetable on when they will be making an announcement on the "make-available" provision. Obviously, it is of great interest to everyone here. For the record, this Senator supports an extension.

I would also like to hear from all of our witnesses on what they think of the program going forward. Should it be left to expire? Can the private market take over? Should the program be extended? Can it be improved? Should companies pay premiums? Should more lines, such as group life, be covered? Hopefully our witnesses will be able to give us insight on these questions.

Once again, thank you, Mr. Chairman, for holding this hearing, and I welcome all of our witnesses before the Committee today.

Chairman SHELBY. Senator Dodd.

STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Thank you very much, Mr. Chairman, and I would ask consent that the full context of my opening statement be put in the record.

Chairman SHELBY. Without objection, so ordered.

Senator DODD. Most of the comments that I would make have been made, and, first of all, let me thank you for doing this, Mr. Chairman. This is exactly the kind of oversight that should be occurring, and I think you and Senator Sarbanes have done a terrific job in this Congress in having good sets of hearings on a variety of issues and exactly the function of a legislative committee like this, once you pass a piece of legislation like this, then to go back at this juncture and actually review what happened. As Senator Bunning and others have pointed out, we were in unchartered waters when we did this. We did something we had never done before, and the good news is we have not had to test it in any real sense. It is very important to evaluate how things are proceeding, so I cannot emphasize enough the importance of having this type of a hearing.

I appreciate Senator Sarbanes' very generous comments, but I thank him as well. He put a lot of time into this issue when we were drafting it. Senators Schumer, Reed, Corzine, and Bennett did a lot of work on this as well. And there are a lot of people, some of whom are gathered here in this room, Mr. Chairman. People like Nick Calio at the White House who was tremendously helpful. Nick is in the private sector today, but Nick did a tremendous job working with the Administration and getting us to the point where we were able to pass the legislation. I cannot emphasize enough how important that the Coalition to Insure Against Terrorism was in getting this done, and there are some people in the room here today who I thank immensely for their efforts.

I am hopeful as well that we can, first of all, get the "make-available" section done. Senator Bunning has it right. We have to do this. Just remember what we are doing here. I think all of us understood, particularly with large real estate projects, the idea of a 3-year bill was probably unrealistic. We all knew it at the time. But the political realities were that you could not get a 5-year bill. No one wanted to be a part of, or very few wanted to be part of, a 5-year bill, even though most understood that the private sector realities were that a bill of 3 years' limitation was probably not going to be adequate to cover the kind of fact situations as you develop larger projects. As Senator Sarbanes pointed out, the "make-available" provision was to extend through the 3 years. It was only as a result of a compromise we had to strike that we moved it back.

Now, my hope is that that will not delay on that and that will be accomplished, and then to evaluate whether or not we need to extend. We have all heard from various people who have come by to talk about the importance of extending beyond the sunset period here, and our witnesses can shed some light on that as to whether or not they think this is a wise thing to be doing.

The good news is what we have not heard over the past 18 months, and that is the public outcry from businesses and workers whose livelihoods are threatened by their inability to purchase coverage. And while we have not been hit with another attack, which we are all deeply grateful for, at least in this country, certainly there is a psychological impact that is occurring in terms of how people respond economically. And the purpose of this legislation was twofold: One, to cover against a catastrophic event, and two, to inject confidence into the market, to get people to act and do things. So it was not necessarily waiting for some event, but to say to people, look, we want you to continue doing what you are doing, it is critically important for the economy, and we want you to know that we are behind this; we are going to try and work with you through this period of time.

To that extent, based on what I have heard, anyway, this is working pretty well. Obviously, we are going to hear from witnesses today who may shed some additional light on this. This was, I think, a very good effort, but it took too long. I think Senator Bennett made that point. We got bogged down in tort reform on this bill, which never should have happened. But it did, and people wanted to use this as some vehicle for a larger set of issues. Unfortunately, we spent a lot more time on this issue than we should have at the time, but, nonetheless, it is a good bill. It is working well, and, again, Mr. Chairman, I thank you immensely for giving us a chance to hear from Mr. Roseboro and other witnesses about where we stand today.

But let me join Senator Bunning and others who have made the point: Let us get this "make-available" thing done. Fooling around with this too much longer is not helping the underlying purpose of the legislation. I know there are some people at Treasury who never liked the bill to begin with. But, that is not the point and they should not be calling the shots on this. And so let's not, you know, delay on this. Let us get that clear. Let us send a message where we are on that and move forward. That would be a tremendous help right now. If we get nothing else out of this but a clear signal from the Administration that the "make-available" provisions are going to go forward, that would be great news and would help tremendously.

I am anxious to hear what you have to say, Mr. Roseboro, but I hope what you have to say includes that.

[Laughter.]

Chairman SHELBY. Senator Dodd, we are glad you are here.

Senator SARBANES. There is the testimony for the witness.

[Laughter.]

Chairman SHELBY. The first panel will be the Brian C. Roseboro. He is Under Secretary for Domestic Finance, the U.S. Department of the Treasury. Mr. Secretary, your written testimony will be made part of the record in its entirety. You proceed as you wish. We welcome you here today.

STATEMENT OF BRIAN C. ROSEBORO
UNDER SECRETARY FOR DOMESTIC FINANCE
U.S. DEPARTMENT OF THE TREASURY

Mr. ROSEBORO. Thank you, Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. I will just give a brief summary of the submitted written testimony and make myself available for your questions.

Congress enacted TRIA in the fall of 2002 to address market disruptions for commercial property and casualty terrorism risk insurance caused by the terrorist acts of September 11, 2001. TRIA established a temporary Federal program of shared public and private compensation for insured commercial property and casualty losses resulting from acts of terrorism covered by the Act.

By most indications, TRIA has been successful in achieving the fundamental goal of enhancing the availability and affordability of property and casualty terrorism risk insurance, particularly for economic development purposes. In terms of affordabilty, while information is still somewhat preliminary, accounts that we have seen indicate that premiums for terrorism risk insurance have decreased significantly throughout the early stages of TRIA and continue to do so.

Despite TRIA's apparent success, there have been widespread reports that the "take-up" rates for TRIA coverage have been low. Whether this reflects a lack of interest in terrorism risk coverage at current prices, a lack of awareness of the availability of coverage, an assessment by businesses of low terrorism loss risk, or a combination of the above will require careful study and analysis of information reflecting as comprehensive a view of markets as possible.

Treasury has the chief responsibility for implementing TRIA. Perhaps the most daunting, immediate administrative task was to prioritize and undertake the actions needed to make the program operational right away. One of the key factors in this regard was that TRIA became effective immediately on November 26, 2002, when President Bush signed the Act into law.

Treasury's first action was to issue promptly a series of three interim guidance notices. These interim guidance notices provided the basis for insurance companies to proceed with offering coverage by addressing issues such as compliance with TRIA's required disclosure and "make-available" requirements; determining which insurers were required to participate in the program and how their deductibles would be calculated; and the scope of coverage under the program.

Even while the interim guidance process went forward, we began the next step in the implementation process to move forward with formal rulemakings that would incorporate and supersede our interim guidance. Subsequent rulemakings have addressed issues associated with State residual market mechanisms, claims processing, and litigation management. Overall, Treasury has published two interim final rules and three proposed rules, and three of these rulemakings have been finalized.

In addition to the regulatory actions outlined above, Treasury has also created and staffed a Terrorism Risk Insurance Program office, or TRIP, to administer the Act. Among its accomplishments, the TRIP office has developed systems to handle claims processing, payments, and auditing of claims should an event ever occur.

It is important to stress that while we have been moving progressively through the rulemaking process, the program from the beginning has been and continues to be fully operational. From the earliest days of the program, we have had procedures and resources at the ready to respond to any covered insurable event that might arise.

Treasury still has some important tasks to complete. First, the Secretary of the Treasury is required to determine by September 1 whether to extend TRIA's "make-available" provisions into 2005, the third year of the program. Treasury is now developing a base of information from which the Secretary can make this required determination. As part of this process, on April 29, 2004, Treasury submitted to the *Federal Register* a request for comments on whether to extend the "make-available" requirement. Comments will be accepted until June 4, 2004. We encourage any who have views on these questions to respond to this request for comments, with as much detail as they can provide.

Second, Treasury is required to report to Congress by June 30, 2005, on specific issues associated with the Act and its purposes, including the effectiveness of the program and the likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the program.

Together with this analysis, Treasury is also required under TRIA to compile information on premium rates for property and casualty terrorism risk insurance. To assist in the evaluation of the Act's effectiveness, to meet TRIA's premium information collection requirement, and to ensure we do so with a comprehensive view of the markets as much as possible, Treasury has contracted with an outside research firm to conduct a comprehensive survey with a nationally representative sample of policyholders and insurers.

Each company chosen for the survey is to be contacted at least twice and possibly three times to capture effects of changes in TRIA's insurer deductibles in successive program years. Surveys for the first wave were mailed out in late 2003 and early 2004 to over 30,000 policyholders and almost 500 insurers. This phased structure will allow us to move beyond snapshots and anecdotal evidence to obtain a broader and more dynamic view of the conditions in the marketplace.

The completed survey results, as well as consultations with a wide range of interested parties, will form the basis for Treasury completing its report to Congress on the effectiveness of TRIA and the capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the program by the June 30, 2005, deadline set by Congress.

While we hope that we will never be called upon to trigger coverage under TRIA, this program stands ready today, as it has from its earlier days, to meet its responsibilities. The basic goal of TRIA was to develop a temporary backstop for property and casualty terrorism risk insurance so that private markets would have a chance to adjust. We encourage insurance companies, State insurance regulators, other financial service providers, and other interested parties to think creatively in this regard, and to consider what methods can be employed to allow for broader private sector involvement in the market for managing property and casualty terrorism risk. Treasury looks forward to completing our review of the effectiveness of TRIA and considering the many complicated issues presented to us in a thoughtful manner with the best information that can be obtained in the weeks and months ahead.

Thank you, and I will be happy to answer questions.

Chairman SHELBY. Thank you, Mr. Secretary.

Secretary Roseboro, in your written testimony that you alluded to and that has been made part of the record, you highlight anecdotal reports of low take-up purchase rates for TRIA coverage. Why do you think there have been low take-up rates?

Mr. ROSEBORO. At this point in the analysis——

Chairman SHELBY. By take-up rates, a lot of people know, but explain what you mean.

Mr. ROSEBORO. By "take-up," we mean the percentage of people who have availed themselves of paying for the terrorism risk insurance coverage provided under TRIP, and some of the private sector surveys that we have seen put that number between 25 to 30 percent in general. Some of the theories that we are looking at in terms of explaining this low "take-up" rate again have to do with risk perception by the businesses as to whether or not they believe they are in a targeted area, or targets themselves individually, if not in a targeted geographic location. How much of it has to do with the cost of the terrorism coverage is an important component that we will be examining, and that is one of the critical, important questions that we are asking in the surveys, and in our conversations with stakeholders and the industry as to what is driving that low participation rate.

Chairman SHELBY. Would you discuss in a little more detail this morning the process that the DOT will use to make the "make-available" determination, the steps you will go through.

Mr. ROSEBORO. The "make-available" determination, as a number of other Senators mentioned, is very important. As we have been discussing with people in the industry over the last several months, over the last year, the importance of coming to a decision on "make-available" sooner rather than later is understood. As I indicated, we have gone out for public comment, and I would characterize that as not an initial step, but a latter step in terms of looking to come to a determination. It is our intention once that comment period closes June 4, to come to a conclusion as soon as possible.

Chairman SHELBY. Are you confident that you will have at the Treasury the requisite information to make the judgment that you need to make here?

Mr. ROSEBORO. For this initial step, yes, sir.

Chairman SHELBY. Secretary Roseboro, when TRIA was passed, it was supposed to be a stopgap measure that has been talked about here, that would allow the insurance industry some time to come to an understanding of how to price the risk of terrorism. The written statements of many of the witnesses indicate that the insurance industry is not yet willing or capable to step back into the field. In order to have a proper discussion about the future of the TRIA Program, I believe we need to have an understanding as to when if at all we can expect the insurance industry to provide terrorism coverage without Federal assistance. In order to address the question, I believe we need to examine the basics of the business of insurance.

Secretary Roseboro, what are the principal factors considered by insurance firms, in your understanding, when they make the decision to insure a particular type of risk?

Mr. ROSEBORO. This is a particularly daunting challenge still for the industry, and again, something that we will be focusing on significantly in our survey.

Chairman SHELBY. But this goes to the heart of what we——

Mr. ROSEBORO. Absolutely. To form some type of actuarial basis to calculate the risk, and appropriate pricing for that risk for the type of outlier events we are looking at is still a major challenge, and in our conversations that answer is not there as of yet. Again, we will continue to look.

In addition to the pricing issue, part of the review process is looking how the market has evolved and finding if there are other mechanisms to share risk. One of the areas, as an aside to that, we are looking at are the developments—and again, this is on the margin and not going to be an immediate solution—in the catastrophe bond market, where the securitization of risks of hurricanes and earthquakes is beginning to evolve. And again, that process is still just on the margin, and still very new.

We were recently made aware that, I believe it was last year, a castastophe bond of that type and that family was utilized to hedge the risk of loss due to terrorism connected with the World Cup soccer matches in Germany in 2006, and that bond received an investment grade. Again, these securitizations are exceptions and on the margin.

Chairman SHELBY. Or perhaps the Olympic Games in Athens?

Mr. ROSEBORO. Yes, although we have not heard of any catastrophe bond insurance taken out for the Olympics, but obviously that is of very much concern in terms of the dynamic of terrorism risk.

Those are definitely some of the challenges the industry faces. There is no model that can predict a terrorist event, but those are the types of things we will be looking at and discussing with industry participants as to the likely evolution timeline of risk sharing, risk dispersion in the industry through financial——

Chairman SHELBY. Are you saying that insurance firms, right now as we sit here, cannot conduct such analysis? In other words, they do not have the right model yet, and if so, will they be able to at the end of the program? Will they ever be able to do this? I mean that terrorism is a new concept, a new phenomenon that insurance people have not had to deal with in the past.

Mr. ROSEBORO. I would say right now I would doubt seriously if they are in a good position to have confidence in a particular model. A lot of good work that is going into this, but as to how long this process will take, that will be the focus of our surveys and discussions with the market as to what is a realistic expectation of how this can evolve.

Chairman SHELBY. Senator Reed.

Senator REED. Thank you very much, Mr. Chairman.

Thank you, Mr. Roseboro.

We all know that the TRIA has a hard expiration date of December 31, 2005, and that has caused us and the industry some planning problems at least. One area I am particularly concerned about is the worker's compensation system. As Commissioner Williams of Delaware notes in her written testimony, "worker's compensation coverage is defined by State laws, and State laws do not typically allow for exclusions for terrorism coverage." In my own State, the burden of worker's compensation is borne by one mutual insurance company created by the State. So without this Federal backstop or the ability to exclude coverage for terrorism, the worker's compensation program is going to be seriously compromised.

What is your view on this issue, and what might be done to try to allay this situation?

Mr. ROSEBORO. Several months ago, we started asking questions of people in the industry coming in to see us as to, besides other issues, whether or not there were any operational considerations that we had to factor in here in terms of policy renewals and looking forward. It was brought to our attention that the insurance business calendar does not necessarily sync up well with the calendar year the statute provided. So, we are well aware of that situation and are looking seriously at what problems this potentially could cause. If there are going to be significant problems, or there cannot be conditional exceptions worked out with the State regulators in terms of the insurance business cycle, then is there anything we need to do in terms of our timeline in making a decision? That is something that is at the front of our radar screen and we are looking to factor it into this process.

Senator REED. This area of worker's compensation, I ask you to spend particular attention, because unlike other insurance where the company itself can verify the terms and you can negotiate, typically as we all know, these are State laws which would require legislative action by States to make changes. My concern is that that will not take place, and we could find ourselves in a very difficult situation. I would urge you to pay particular attention to worker's compensation.

When this issue came up 2 years ago or so, I was surprised when the worker's compensation insurers came to me, because we are talking about property insurance, but if you stop and think about it, if there is a catastrophic event in one particular area, one company, those survivors are typically covered by worker's compensation, so we have to think more seriously about that.

We all understand there is an increased risk of terrorist incidents. In fact, the President has basically said, in response to questioning, that he anticipates something might happen. I do not think they are looking at this hard date as a planning guide in terms of their potential threat to the United States, the terrorists. Also, as you mentioned, the rolling expiration dates of policies, the Treasury study is not due until June of next year, and so valuable information that might be gleaned by that study, 6 months basically between then and the expiration date.

From the Administration's point of view, what harm would there be in a short-term extension of the TRIA?

Mr. ROSEBORO. Well, again, at this point we have drawn no conclusion about extension, nonextension, or whether a short-term extension would be useful, whether an extension with modifications should be considered. But that is what we would be focusing on, those types of issues, in doing the analysis as to where it would be most useful, because again, it comes back to what has been the evolution in the market, keying in on availability and affordability of insurance. That is why we, when we reach out to the market, we are not only asking for "yes" or "no" in terms of renewal, nonrenewal, but also if there is to be a renewal, are there modifications that could continue, either that we can do, or that we could recommend to the Congress to do, that could enable the industry to continue to move forward if sufficient progress has not been made.

Senator REED. Just one final question, Mr. Roseboro. Can we presume that this recommendation to us will not be any earlier than next summer when the report is finished, or would you anticipate a recommendation to us sooner than that? We have a calendar which is too difficult.

[Laughter.]

Mr. ROSEBORO. We would hope to, again, factoring in those considerations which may, given their importance and the findings that we start to see in the next few months as survey information becomes available. We are not looking at being inflexible about our calendar. Again, we are working on that timetable now, but as with the "make-available" situation, if the evidence starts to point for decisions being needed to be made earlier, rather than later, because of complications to the industry which could undermine the support that the Act was set to foster, then we will adjust accordingly.

Senator REED. Thank you very much, Mr. Roseboro.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Bennett.

Senator BENNETT. Thank you, Mr. Chairman.

Let me just be sure I understand the timetable you are talking about, Mr. Roseboro. You have a comment period on the "make-available" which expires June 4?

Mr. ROSEBORO. Yes, sir.

Senator BENNETT. If I understood you correctly, you were viewing the end of that as not the beginning of your decisionmaking process, but rather toward the end?

Mr. ROSEBORO. That is correct.

Senator BENNETT. I can understand that you do not want to make a decision before the comment period is up, and June 4 is coming right up. If you got a letter from some of us on this Committee—we are circulating drafts among us, Senator Dodd and I and others, urging you to act as quickly as you could after June 4—would you be appreciative of that kind of statement on our part?

Mr. ROSEBORO. I would be appreciative of any letter from this Committee as a general rule.

[Laughter.]

Senator BENNETT. Not to steal Senator Dodd's thunder, but I think you can anticipate such a letter signed at least by the two of us, and we are going to get as many additional signatures as we can find.

I am encouraged by the fact that you are not using the comment period as a delaying tactic as sometimes happens, where a bureaucracy says, “Well, the comment period will not even be over until June 4, and we are going to require 90 days to read to read all the comments.” So, I want to underscore the fact that now is the time to be reading them, and close of business on June 5 would be a nice time for us to have a——

[Laughter.]

—a response.

Mr. ROSEBORO. A little ambitious, but it certainly will not be months. It may not be days, but certainly not months.

Senator BENNETT. I understand that.

I think all the other issues have been covered, Mr. Chairman. I just wanted to make that point.

Chairman SHELBY. Thank you.

Senator Dodd.

Senator DODD. Thanks, Mr. Chairman.

You had mentioned at the outset, the Terrorism Risk Insurance Program—the staff at Treasury deserves a great deal of credit, by the way. They have done a lot of work in a short period of time, Mr. Chairman, and sometimes we forget to recognize the people who do not appear as witnesses, who do not get to be quoted in the press about how these things are working, but they have done a very fine job. Out staffs have worked very closely with them, and we are very appreciative of the work. So please communicate to your staff how much we appreciate what they are doing.

There is a draft of a letter moving around here, and that Senators Bennett Corzine, Schumer, and I will be sending to you, and we are circulating it among our colleagues to see if there is some additional interest. I think you received a similar letter from the House. Congressman Blount I think and others have expressed a similar interest. And again, June 4 is coming up pretty quickly, but just a couple of questions. One, are you receiving any comments in opposition to the——

Mr. ROSEBORO. Yes, we have received comments in opposition, not only to “make-available,” but also, even though the comment period is about the “make-available,” we are receiving more comments about the renewal of TRIA or non-renewal of TRIA——

Senator DODD. This is about “make-available.”

Mr. ROSEBORO. We have seen a few, yes, a few.

Senator DODD. But the overwhelming majority are in favor of the “make-available?”

Mr. ROSEBORO. Yes, and again, with the comment period still open I do not know what the——

Senator DODD. Give me a public policy argument as to why you would not want to extend the “make-available” period? What are they saying?

Mr. ROSEBORO. Again, this is a snapshot, but as to those who would be against it, the reasoning ties to the overall program and the low “take-up” issue as some evidence that it is not needed. Is this just a barrier to whatever is needed or is the private sector market operating efficiently?

Senator DODD. But it mostly has to do with the underlying legislation?

Mr. ROSEBORO. Yes. Most of the comments are directed more at the underlying legislation.

Senator DODD. I gather you understand the significance of trying to get an early answer on this. You do not have to wait until September 1. The law says by September 1.

Mr. ROSEBORO. Absolutely, sir. Again, as we have been discussing this issue with industry participants over the months, we have heard and understand the significance of this issue to the industry.

Senator DODD. You are hearing us up here, obviously. From an industry standpoint it is very, very important.

And the reauthorization issue, Mr. Chairman, I do not know how we are going to proceed on that, but again, this is a similar question. While it is not until June 2005, as we have all learned, for planning purposes, from a business standpoint, having some clear indication of what Congress is going to do one way or the other, it seems to me, becomes very, very important, and I do not know what the intentions are of the leadership in terms of these kind of issues. I do not know if the House is going to move on this or not. Obviously, they have an easier time of moving legislation because of the rules of the House, but would you agree, Mr. Roseboro, that it is important that by the end of this legislative session, that we have a clear indication of whether or not we should reauthorize this program beyond June?

Mr. ROSEBORO. In terms of the overall program, we really feel strongly and believe that to offer you the best advice and counsel possible, we need to do this thorough analysis. We think the approach that we are taking, reaching out, again, to as many as 30,000 policyholders and 500 insurers, will give us a good basis in fact to give you a credible picture of the market, of the evolution that is going on in the market, and what the necessary needs will be. Until we have that, we will not be serving you well in terms of advising you on this issue.

Senator DODD. Let me jump quickly, Mr. Chairman, just ask about rates, and I know there is no definitive evidence at this point of who is buying terrorism insurance and the affordability of such insurance. Several studies have been conducted recently. In one study, Mr. Chairman, conducted Marsh, it states that take-up rates, that is who is purchasing terrorism insurance, are consistently rising as the prices continue to decline. I wonder if you would share with us whether or not you believe this analysis is correct, and whether or not you believe without the total backstop provided by TRIA, if this trend would continue? Are you familiar with the Marsh study?

Mr. ROSEBORO. Yes, yes. Again, looking forward, the information that we collect in our study will help validate, invalidate, contradict, and supplement, some of these private sector snapshots to date.

From a price perspective, the information we have is that prices have been coming down. However, this is relative. They are still higher than they were pre-September 11, not surprisingly.

Senator DODD. Is there any doubt in your mind what would be happening in the absence of TRIA. What would have happened?

Mr. ROSEBORO. I think it would have been detrimental for the economy in the absence of TRIA. It was definitely necessary to have this program to provide stability and support for economic development. So in terms of TRIA's mission, we believe it was a success and fulfilled. As we look forward now, the critical issue, is whether the market is ready to stand on its own two legs or not, and that is the critical question we are asking now. But we absolutely believe TRIA was necessary, and did what Congress intended it to do.

Senator DODD. The overwhelming amount of evidence you are receiving to date from industry is that they would like to see this renewed, that it is critical for them to have this program remain in place for at least another couple of years?

Mr. ROSEBORO. Definitely as to the "make-available" extension. Again, as to the broader surveys, it is not clear, whether the information we have received to date is truly representative, or rather it is the case of a vocal minority. We want to be very firm in terms of understanding the broader industry and its dynamics and effects.

Senator DODD. Thank you.

Mr. Chairman, I would ask unanimous consent that this draft of a letter from Senator Bennett and I be included in the record.

Chairman SHELBY. Without objection, it will be made part of the record

Senator DODD. Thank you, Mr. Chairman.

[The letter follows:]

Chairman SHELBY. Senator Allard.

Senator ALLARD. Mr. Roseboro, I am going to paint a scenario, and I would like to have you comment on it. Right now our economy is doing well. We are in economic growth, and if you look at all the statistical figures, it seems to me that if we were ever to look at a time when we were beginning to turn this over to the private sector, you would do it during a time when the economy is doing well and growing. It seems to me that once a sector of businesses become dependent on some subsidy from the Federal Government, they do not like to change it because it means, in this case, if they do not get that subsidy, then there is going to be an increase in premiums which has an adverse impact on demand, and makes it more difficult for them to reach the bottom line, something like the Farm Program. We have seen what has happened with the Farm Program subsidies. I think there will always be a demand from the industry for this subsidy because it is going to make it more difficult for them to market their product because the price of it has to go up when you do that.

What do you see us being able to do in the next year or 2 or 3 years to make this turn over more to the private sector with less involvement from the Federal Government?

Mr. ROSEBORO. In addition to assessing, as you characterize it, whether the need still exists and can the industry adapt without this type of support?

Senator ALLARD. Let me just stop you right there. How are we going to measure needs, just by demand by the industry, or do you have some other way of measuring needs? I mean these things have to be thought about. Go ahead.

Mr. ROSEBORO. Yes, absolutely. Again, there will be a number of factors in the broader survey that we will try to get a handle on as to the need. But, thinking back to the initial program and why it was necessary and what were the clear impediments, the questions as to whether economic development projects are being impeded because of the inability to attain this type of coverage is one of the obvious criteria we will look at, as well as how that has evolved over the last 3 years in going forward.

Are there reasonable substitutes or adjustments that could be made outside of a renewal of TRIA that will work just as well, if not better, in terms of moving the industry forward if it still needs a boost? We would also be looking for those types of adjustments, whether they have to do with this financial information, or possibly invovle regulatory changes in terms of reserves. Those are the types of issues we will further explore in terms of alternatives, not looking at this as a binary decision, leave the TRIA as it is or not; but, what else could be done if it is assessed that the market still needs the support in order not to impede economic development.

Senator ALLARD. Actually, the legislation says that you will make a decision by September 1, I think, is that correct?

Mr. ROSEBORO. I think it uses the word by September 1.

Senator ALLARD. By September 1. I understand the need to make a decision early so that companies can respond with their policies and whatnot as they go through a renewal period here, and I can understand that need. Then the program is supposed to stop, the way we have drawn it up, on December 31, 2005. How do you see us if we were to phase this out over time? How could we do that?

Let us assume the decision is, we get into this year, it is obvious our economy is continuing to do well. What mechanisms could we put in the legislation that would phase this program down and move it so that we were before September 11, where we relied on the private sector to provide this coverage on its own without a subsidy from the Federal Government?

Mr. ROSEBORO. That is a very good question, especially in regard with the September 1 "make-available" and how we are looking at just that process. We look at the decision that will be made by or before September 1 as not necessarily by any means determining what the final report or our evaluation will be by the June 30, 2005——

Senator ALLARD. I am already making the assumption that things are going to go well and we need to phase it down.

Mr. ROSEBORO. What we are talking about here is, if there is going to be a change in policy or whatever the policy outcome is going to be, preparing the market for that outcome, so that there will be no surprise to the market. Being able to communicate, that is having a continuing dialogue with market participants between now and that period will be important in order to minimize surprises as to any change in policy course, and whether to continue Government action or non-Government action. We will work very hard with the Congress as well to make sure that there is effective communication going on in order to manage expectations, operational issues, and policy issues with this regard.

Senator ALLARD. I am not sure I got an answer on that.

Mr. ROSEBORO. I was going to say, in terms of any specific prescriptions that Congress could take at this point we are not prepared to offer those.

Senator ALLARD. Will you be prepared to offer those at some point in time?

Mr. ROSEBORO. Potentially, as we begin to get the survey data in and get a better picture, a moving picture of where the industry is headed or not headed. I would expect that we would have communications with this Committee as to what our findings would be. While we may not necessarily make those findings public as we go along, that would be something in private we would be more than happy to share with the Committee to help shape expectations and prepare for whatever policy initiatives would be appropriate.

Senator ALLARD. The debate that is going to go on here is whether we make this a permanent program or not I think, because I think the more we extend it, the more it is going to become a program, and like I said in my opening comment, I think the industry has to be honest with us. If they going to start planning on this as a permanent program, they had better make that clear, so that in this debate we can understand.

But I think right now the way the legislation was designed, it is a temporary program, and I hope that you will be prepared to come forth at some point in time during this debate when we have it in this Committee—you are not ready today—but we have to have some idea of how we could put in place to phase this program, because right now that is the policy of the Congress, and that is what is passed, and I think we need to be prepared, as that as an eventual—I do not see how it cannot be a part of the debate, and if you are prepared to give us some recommendations, I think would add substantially to the debate, so I would encourage you to provide that to the Committee.

Mr. ROSEBORO. I will work on that, Senator.

Senator ALLARD. Thank you.

Chairman SHELBY. Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Thank you, Mr. Chairman.

Let me go back and ask a question if I can, Mr. Secretary, about why do you think the private market has not responded and filled in the void over the last couple of years?

Mr. ROSEBORO. From of the evidence we have seen to date—and again, we do not necessarily believe it is enough data, which is why we want to continue to do the survey, to get a better handle on that question—there is, on the surface at least right now, several dynamics that are occuring: From the insurance side, an inability to model and adequately price coverage; from the policyholder side, behavior based on whether or not there is an expected value or a risk perception that there is not a need for coverage. Whether policyholder behavior has to do with a geographic area, as some not living in a major urban area may feel they have less need of this coverage than those living in a major urban area; to price sensitivity and the feeling that the coverage still is too expensive; or to the feeling that there will still be help if a major terrorism event occurs again, impact whether or not the entity has bought the insurance.

So we have heard of these different motivations, or theories about these different motivations from all sides. And again, that is why we feel it is important to do a thorough survey analysis of this process to get a handle on what is driving either the development or nondevelopment of the private sector coming back and being able to offer this product, which is in demand by some policyholders.

Senator CARPER. I recall when we debated this issue a couple of years ago, there were concerns relating to economic development, job creation, particularly with respect to the construction of major projects, stadiums, arenas, convention centers, that kind of thing. Have we taken a look to see what effect the adoption of this legislation has had on encouraging those projects to go forward?

Mr. ROSEBORO. We have, and we will continue to do so. The evidence and information we have so far is that TRIA has been supportive of enhancing the economic development, allowing major projects go forward at a reasonable cost and reasonable financing. Again, the question is, is it still needed from here going forward? That is what we will be intentionally looking at, and taking several periodic surveys of the market to see if there is progress, if there is development, if there is a change in pricing structure, if there is a change in demand.

But up to date, we would say TRIA has been very supportive of those types of projects.

Senator CARPER. All right. To change gears just a little bit if I could. I do not have a pure recollection of this, but I seem to recall some discussion 2 years ago when we were looking at the issue of whether or not group life insurance should enjoy participation in this program. My recollection—you may have spoken to this during your testimony—is that we essentially said that Treasury should do a study of the effect or impact on group life insurance. Do you recall what the outcome was of that?

Mr. ROSEBORO. Yes.

Senator CARPER. Just give us a little bit of background first, a little bit of a primer and then what happened.

Mr. ROSEBORO. As I understand it, group life insurance was not included in TRIA in terms of coverage, but Treasury was tasked with the responsibility to a study whether or not it would be appropriate to include group life insurance. And then this is key in terms of what led to Treasury's conclusion on this. As the Act was written, the criteria that group life would have had to meet would have been that both the reinsurance as well as insurance available to consumers would have been unavailable. As was the case then, as I believe it is now as well, reinsurance is unavailable. There is a big problem with that without a doubt.

However, group life insurance was still available, and actually still is now available at competitive rates, in still a pretty competitive market. Treasury ruled against adding group life into TRIA principally because, based on the Act, it did not fit the two-prong criteria of unavailable reinsurance and insurance to consumers, and insurance is available.

However, part of the looking forward study, is to say that not only is it available now, but will it also continue to be available. So, as Treasury continues to look at the overall issue, we will continue to look at whether there are any changing dynamics on the group life side, that even though insurance is available now, there could be problems down that road, so that will be an aspect we will continue to look at.

Senator CARPER. Good. I am glad to hear that you are doing that, and thanks very much.

Chairman SHELBY. Senator Bunning.

Senator BUNNING. Thank you, Mr. Chairman.

Most of the things have been covered, but can you give us an update on the financial institutions, what steps they have been taking to guard against terrorist threats—the financial institutions that absolutely need this type of coverage if they are going to lend money to programs.

Mr. ROSEBORO. That is something, sir, I will have to get back with you on, in terms of any general pattern. Again, there have been differences along geographic lines in terms of the financial institutions or other institutions taking up coverage, as opposed to not taking up coverage, depending on where they are located. But just in terms of coverage for the terrorist event, disrupting them, I promise I will have the office get back to you on any more specific patterns that we have seen. And that, again, is something that the first round of surveys that has just gone out may show, but and all of the answers have not come back yet.

Senator BUNNING. I would appreciate that because that has a great deal to do with whether the private sector obviously gets back into the business, which they are not presently doing. And, obviously, if the Federal Government gets out of the business, who is going to fill the gap. That is all of our concerns up here. The reason we passed this to start with was because we were convinced that the private sector was frightened about the prospects of covering so much of a project or a risk that they would not do it unless there was a backstop by the Feds.

Mr. ROSEBORO. Yes. On that basis—I am sorry. I think I misunderstood the question—the financial institutions are there, again, but they are indicating to us that they need TRIA to stay there, and that is what we will continue to look at and broaden out, in order to see how widespread that is, whether or not there are any alternatives, how they would adjust their pricing, how they would continue to make the coverage available and whether or not there would be any geographic or industry significant changes in the absence of the Government backstop.

Senator BUNNING. In other words, can you give me a personal or a Treasury opinion if we did not renew or extend this program? Do you think that the private sector would get back into the business or not?

Mr. ROSEBORO. Personally, again, from Treasury's standpoint, we really need to do the survey. Personally, I think it would be cherry-picking type of situations, where in some cases, yes; some cases, no.

Senator BUNNING. In other words, they would insure in Paducah, Kentucky, and they would not insure in New York City.

Mr. ROSEBORO. Exactly. Or if they insure in New York City, it would be at rates that ensures policyholders would be tempted to go without coverage. Again, the biggest problem comes back to pricing. If they can be comfortable with pricing, I think you can see more people come into the market and competition evolve such that things would be back to more of a normal basis.

Senator BUNNING. I am looking forward to your survey and the return of the data from your insurers and your perspective buyers of that insurance without a backstop or with one because I think that is very important for this Committee to have.

Thank you.

Mr. ROSEBORO. Absolutely.

Chairman SHELBY. Mr. Secretary, thank you for your appearance here.

Senator SCHUMER. Mr. Chairman.

Chairman SHELBY. Oh, we have Senator Schumer here with us. Thank you.

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Thank you, Mr. Chairman, and I appreciate it, and thank you, Mr. Secretary. I apologize for being late.

As you probably know, I was one of the people who pushed hardest for this insurance. Obviously, coming from New York City, it is crucial to us. Let me just make it clear. This is not an "if" situation for New York City and many other large cities. Without terrorism insurance, our economy will suffer, it will call into doubt whether new construction, whether rebuilding, whether the return of downtown New York will happen.

And so what concerns me here is Treasury's attitude, which I guess I call, somewhat charitably, lackadaisical on this issue. Here is what I am worried about. Obviously, the renewal for the next year to "make-available," you said earlier you would move on in the next 3, 4 weeks, after the comment period ends.

Mr. ROSEBORO. As soon as possible, yes, sir, after the comment period ends.

Senator SCHUMER. That is crucial. But I am really concerned that the time table for renewing the bill, as I understand it, the report will not be issued, and we will not even be able to get started on this until next summer, and insurance contracts are not written to, you know, if you say it is okay to have terrorism insurance on July 15, that does not mean, okay, by July 30, everyone signs up and everyone lives happily ever after. There are often 2-year contracts or longer. There is uncertainty. Builders will not plan to build.

I am extremely concerned about the time table. Why can we not speed this up? Do you see any dangers of waiting until next summer to make a decision based on this information as to whether we should renew terrorism insurance?

Mr. ROSEBORO. Treasury takes this critically—it is very, very important, sir.

Senator SCHUMER. Well, we have not—in all due respect, and I will let you finish—we have not heard from Treasury. People go into Treasury and do not get any sense of alarm or any sense of real concern. We hear nothing. You have not taken a position on the "make-available." You have not taken a position on whether we need to continue terrorism insurance. This took back-breaking work, and it happened at the last minute, and, frankly, the reason, I guess I am a little dubious, is that Treasury had to be pushed, and pushed, and pushed by some of us on both sides of the aisle, but by their friends in private industry to get this done at the last minute last time.

I would like to hear your concern, and particularly I would like to hear whether you think it is essential or you think we could do fine without it, but more importantly I would like you to address the time table—why do we stretch out the time table? And even if we should renew it next fall—the fall of 2005—we will do untold damage to the economy in large parts of the country.

Mr. ROSEBORO. From the date the bill was signed, Treasury has stood ready to execute its responsibilities, and the policy staff, especially the career staff, has worked very hard to make sure there would never be a problem implementing, if needed. Fortunately, we have not needed it yet.

As we have worked, given the Act's time tables given to us, we have made adjustments where proven necessary, to move things along. As discussed with the "make-available" provision, the Act indicates the Secretary decide by September 1. As we have been talking to people in the market——

Senator SCHUMER. You mean for the "make-available."

Mr. ROSEBORO. Yes, sir, "make-available." We have been having discussions with people in the industry, the market, hearing from people on the Hill for months, if not over the last year, about the importance of this. We have been having discussions with people in the industry about the operational timing issues, which you mentioned, and we are well aware that the Act, as written, does not line up perfectly with the operational realities of the business cycle when decisions have to be made. So we have continued to work with State insurance regulators on possible scenarios. We have worked hard to gather the information necessary to provide the Committee and the Congress with the information it will need to make a judgment on going forward.

Senator SCHUMER. Sir, I am asking you not whether you are providing information we need or talking to State insurance regulators, give me a reason why Treasury would not say forthwith that we should renew this bill, not just the "make-available," we should renew it, and we should renew it now, given that if we wait until the last minute—do you agree that if we wait until the last minute, we will disrupt the markets?

Mr. ROSEBORO. That is what we are trying to determine, exactly where the markets are now and evolving to.

Senator SCHUMER. Wait. You tell me one person in the industry who builds, who gives insurance, who tells you that waiting until next summer to begin renewing the bill will not disrupt the market. Can you name me a person?

Mr. ROSEBORO. No one has told me that it will at this point. What the industry has engaged us on is the importance of the "make-available" decision, and that is where we have been focusing——

Senator SCHUMER. Then, you and I are in different worlds here. No one in the industry has said to you that it would be a good idea to renew it this year, not next year—no one?

Mr. ROSEBORO. The focus of industry contacts I have had, personally, has been directly for the "make-available" provision.

Senator SCHUMER. What is your opinion on trying to get this renewed this year? Do you think we can afford to wait until the report is issued on June 30, 2005, to begin to decide this?

Mr. ROSEBORO. At this point, given the information I have, I have no predisposition of whether or not it is necessary or not necessary to renew at this point. I see no evidence, at this point, that it is detrimental to the industry not to renew TRIA this year, sir.

Senator SCHUMER. Can I send you some letters that say just the opposite of what you are saying?

Mr. ROSEBORO. Please.

Senator SCHUMER. And I would suggest you reach out to both the insurance industry and the real estate industry. Are you willing to ask them the question whether it would not be advisable to renew it this year?

Mr. ROSEBORO. Absolutely, sir.

Senator SCHUMER. My guess is you will hear an overwhelming loud and unqualified "yes." If you heard that "yes," just assume it, would the Administration be willing to push for renewal this year?

Mr. ROSEBORO. With that "yes," we, at Treasury, as again we have reached out for, we want to understand why. What are the dynamics calling for that?

Senator BENNETT. If I may, Senator, we have the witnesses that will make your point on the next panel——

Senator SCHUMER. Thank you.

Senator BENNETT. —if you will let us get to them.

Senator SCHUMER. But the witnesses on the next panel have about as much power over this as you or more.

[Laughter.]

This is the man with the juice.

[Laughter.]

Senator BENNETT. The Chairman has returned.

Chairman SHELBY. I do not believe we have any other questions of you today, but we will leave the record open for any written questions because there is a lot of concern and a lot of interest, you can tell, by the audience that you brought with you today.

Mr. ROSEBORO. I would be happy to respond to any of your follow-up questions.

Chairman SHELBY. We appreciate your appearance here today, and we look forward to working with you.

Mr. ROSEBORO. Thank you very much, sir.

Chairman SHELBY. We are going to call up the second panel now.

Ms. Donna Lee Williams, Commissioner, Delaware Department of Insurance; Mr. Richard Hillman, Director of Financial Markets and Community Investment, the U.S. General Accounting Office; Mr. J. Robert Hunter, Director of Insurance, Consumer Federation of America; Mr. Jack Degnan, Vice Chairman, the Chubb Corporation, testifying on behalf of the American Insurance Association and a coalition of property-casualty insurance trade associations; Mr. Christopher Nassetta, President and CEO of Host Marriott

Corporation, who will be testifying on behalf of the Coalition to Insure Against Terrorism; and Mr. Jacques Dubois, Chairman and CEO of the Swiss Re America Holding Corporation.

I welcome all of you to the Committee today. You have had the benefit of the Treasury's testimony here, through Mr. Brian Roseboro, and we will go from there.

Please take your seat.

Senator SCHUMER. Mr. Chairman, could I ask unanimous consent that my opening statement be placed in the record.

Chairman SHELBY. Absolutely. Without objection, Senator Schumer's opening statement will be made part of the record.

Senator Carper, do you have something special——

Senator CARPER. Yes, we have a——

Chairman SHELBY. You have a special panelist.

Senator CARPER. Thank you. We have a special guest here from Delaware. I am pleased to welcome Donna Lee Williams, our Insurance Commissioner, who is nearing the end of her third term, and it looks like maybe her final term as our Insurance Commissioner. In some States, that is an appointed position. In our State, it is an elected position. She has been elected Statewide three times and has done I think a very fine job, and so I want to welcome here today.

We are delighted that you are here. And she is here on behalf of The National Association of Insurance Commissioners and serves in a leadership role which enables her to come here and speak with special—I do not know if she brings the "juice," Senator Schumer, but brings a lot of thought and intellect to this job.

Welcome, Donna Lee.

Ms. WILLIAMS. Thank you very much.

Chairman SHELBY. I welcome all of the panelists again. Your written testimony will be made part of the record in its entirety.

Ms. Williams, we will start with you. I hope you will sum up your testimony, briefly.

STATEMENT OF DONNA LEE WILLIAMS COMMISSIONER, DELAWARE DEPARTMENT OF INSURANCE ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Ms. WILLIAMS. I will do the best that I can, sir.

Chairman SHELBY. Sure.

Ms. WILLIAMS. Lawyers and elected officials like myself tend to be long-winded.

Today, I want to make three basic points. And again I thank the Chairman and the Committee for allowing the Nation's insurance commissioners the opportunity to testify regarding this issue. I want to make three basic points today.

First, there is still a need for the Federal Government to provide appropriate financial back-up to the private insurance market in order to assure that segments of our Nation's economy do not falter due to a lack of insurance coverage for terrorism. The insurance marketplace is not yet ready to take on the risk of providing coverage for acts of terrorism on its own.

Second, the Treasury Department should extend the "make-available" requirements in TRIA so that businesses across America will know that they can purchase the terrorism insurance coverage they need to sustain a healthy economy.

Third, Congress should act this year to extend coverage under the Terrorism Risk Insurance Program or enact a comparable Federal backstop for acts of terrorism, at least through 2006, because the commercial insurance markets are not yet prepared to underwrite sufficient terrorism coverage without a Federal backstop.

Following the enactment of TRIA, the NAIC appointed a Terrorism Insurance Implementation Working Group of State Regulators that has worked very closely with the Treasury Department to successfully implement the Act's provisions, as well as to monitor the impact it has had on the insurance marketplace. Although we observe that the take-up rate for terrorism insurance coverage mandated under TRIA has not been widespread, coverage is available for those industries that want to purchase it. We believe the presence of the Federal backstop has provided a measure of comfort to the insurance industry, and has encouraged insurers to offer coverage for acts of terrorism that it might not have made available in the tragic wake of the tragic events of September 11.

Congress can help us continue the progress made in restoring the market for terrorism insurance by doing two things. First, encourage the Secretary of the Treasury to make an early determination that he will impose the "make-available" requirement of TRIA to all participating insurers. The second is for Congress to act this year to extend the expiration date contained in TRIA to a future date that is consistent with the business cycle for terrorism insurance renewals.

Insurance regulators believe extending the "make-available" requirement in TRIA through 2005 will help ensure marketplace stability by continuing the availability of terrorism insurance in all parts of the United States. If insurers were not required to offer coverage, areas of low risk of losses from acts of terrorism would probably experience little disruption. However, those areas of our Nation and prominent cities with attractive targets for terrorism activity might face availability and affordability problems. This would have a negative effect on their local and regional economies, particularly with real estate development.

Earlier this month, insurance regulators began receiving contingency filings from the Insurance Services Office, the Nation's largest advisory organization. In the event Congress does not extend the TRIA program this year, these policy form filings would reinstate terrorism coverage limitations that were in effect prior to TRIA's enactment for any policies written for coverage that extends into 2006. In addition to protecting insurers from additional terrorism liability, these filings demonstrate the insurance industry is not willing to assume the risk of terrorism losses by themselves at this time.

The NAIC's Terrorism Insurance Implementation Working Group believes TRIA's "make-available" requirement has contributed to the overall effectiveness of the program during the program's first 2 years. American businesses, both large and small, have been offered choices they might not otherwise have had. Through the "make-available" provision, TRIA has given them the opportunity to make an informed choice regarding the purchase of coverage for acts of terrorism.

One of the elements the Treasury Department is required to consider is the capacity of the insurance industry to accept the risk of losses from acts of terrorism. The NAIC's data shows 2003 was a profitable year for property and casualty insurers. However, policyholder surplus declined each year from 1999 through 2002. The Treasury Department must consider whether the industry is willing to put its capital at risk. We believe the answer is no.

Insurers in the marketplace at large are finding it very difficult to accurately price coverage for acts of terrorism. Unknown frequency, coupled with the potential for severe losses, makes coverage for acts of terrorism one that insurers might choose to avoid, if given the opportunity. Until insurers and their reinsurers become more comfortable that Government efforts are adequate to protect citizens from terrorist acts or at least become more predictable than they are today, they will be reluctant to accept complete risk transfers from American businesses. In particular, those businesses viewed by insurers as having greater risk of terrorism losses will have trouble finding insurance.

Consequently, the NAIC's Terrorism Insurance Implementation Working Group urges the Treasury to extend the "make-available" requirement. The Working Group met in conference call yesterday. We are also preparing a draft in response to the request for comments issued by Treasury.

In addition, the NAIC urges Congressional action this year on a Federal solution to ensure continued marketplace stability when TRIA expires at the end of 2005. Because some terrorism risks are largely uninsurable without a financial backstop, State regulators are very concerned that significant market disruptions will develop before TRIA's expiration. This is due, in part, to the deadlines contained in TRIA which do not match the business cycle for insurance renewals.

As early as September of this year, insurers and their policyholders will be required to make decisions regarding coverage that goes well into 2006. At present, annual policy renewals with effective dates of January 2, 2005, or later must contemplate that there will be no Federal backstop for any losses occurring in 2006. For this reason, State regulators anticipate widespread insistence by insurers that conditional policy exclusions for terrorism coverage be included in renewal policies starting this year. We encountered this scenario in the aftermath of September 11, which prompted the creation of TRIA.

To address this situation, Congress could simply change one line of TRIA. Extending the program termination date until December 31, 2007, would enable Congress to receive the report from Treasury on June 30, 2005 and allow roughly 15 months to digest and debate any future Federal role in backstopping acts of terrorism.

Other alternatives would be to extend the coverage period in the program without extending the actual effective date of the law or to develop a different type of Federal backstop for acts of terrorism that provides some form of funding for the risk of losses resulting from the acts of terrorism.

In summary, we strongly urge Congressional action to extend TRIA this year. We strongly urge Treasury to extend the "make-available." The State regulators stand ready to assist Congress in developing appropriate methods for continuing the Federal Terrorism Reinsurance Backstop. I thank you for recognizing the expertise in the State regulatory system and allowing us to participate in this debate.

Chairman SHELBY. Mr. Hillman.

STATEMENT OF RICHARD J. HILLMAN
DIRECTOR OF FINANCIAL MARKETS AND COMMUNITY INVESTMENT
U.S. GENERAL ACCOUNTING OFFICE

Mr. HILLMAN. Thank you, Mr. Chairman and Members of the Committee. I am pleased to be here today to discuss our report on the implementation of the Terrorism Risk Insurance Act of 2002—or TRIA—and the Act's impact on the insurance market.

Our report on the implementation of TRIA has two objectives.

First, we described the progress made by Treasury and insurance industry participants in implementing TRIA.

Second, we discussed the changes in the market for terrorism insurance coverage under TRIA.

In short, we found that Treasury has made significant progress in implementing the provisions of TRIA, but has important work to complete in order to comply with all of its responsibilities under the Act.

We also found that TRIA has enhanced the availability of terrorism insurance for commercial policyholders. However, most are not buying terrorism coverage, and those that have remained exposed to significant perils.

Finally, we have learned that industry market participants have made no progress to date toward the development of reliable methods for pricing terrorism risk and little movement toward any mechanism that would enable insurers to provide terrorism insurance to businesses without Government involvement.

More broadly, it appears that Congress's first objective in creating TRIA to ensure that business activity did not materially suffer from a lack of available terrorism insurance largely has been achieved. Since TRIA was enacted in November 2002, terrorism insurance generally has been available to businesses. In particular, TRIA has benefitted commercial policyholders and major metropolitan areas perceived to be at greater risk to a terrorist attack.

Prior to TRIA, we reported concerns that some development projects had already been delayed or cancelled because of the unavailability of insurance and continued fears that other projects would also be adversely affected. We also conveyed widespread concern that general economic growth and development could be slowed by a lack of available terrorism insurance. Since TRIA's enactment, terrorism insurance has generally been widely available, even for development projects in perceived high-risk areas, largely because of the requirement in TRIA that "make-available" coverage for terrorism be made on terms not differing from other coverage.

However, despite increased availability of coverage, limited industry data suggest that only 10 to 30 percent of commercial policyholders are purchasing terrorism insurance. According to industry experts, purchases have been higher in areas considered to be at high risk of another terrorist attack. However, many policyholders with businesses or properties not located in perceived high-risk locations are not buying coverage, perhaps because they view any price for terrorism insurance as high relative to their perceived risk exposure. Some industry experts are concerned that those most at risk from terrorism are generally the ones buying coverage. In combination with low purchase rates, should a terrorist event occur, these conditions could impede business recovery efforts for those businesses without terrorism coverage or cause financial problems for insurers.

Moreover, we found that even policyholders who have purchased terrorism insurance may remain uninsured for significant risk arising from certified terrorist events, including losses involving nuclear, biological, or chemical agents or radioactive contamination. Since September 11, 2001, the insurance industry has moved to tighten longstanding exclusions from coverage for losses resulting from such events. As a result of these exclusions, even those policyholders who chose to buy terrorism insurance may be exposed to potentially significant losses.

Nearly a year and a half after TRIA's enactment, we found that there has been little progress toward Congress's second objective—to give private industry a transitional period during which it could begin pricing terrorism insurance and develop ways to cover losses after TRIA expires. According to industry sources, TRIA's ceiling on potential losses has enabled reinsurers to return cautiously to the market; that is, some reinsurers are offering coverage for terrorism risk within the limits of the insurers' deductibles and the 10-percent share that insurers would pay under TRIA.

However, insurance experts said that without TRIA's caps on potential losses, both insurers and reinsurers likely still would be unwilling to sell terrorism coverage because they have not found a reliable way to price their exposure to terrorist losses. Without being able to set appropriate prices, such losses could lead to insurer insolvency. Not only has no private-sector mechanism emerged for supplying terrorism insurance after TRIA expires, but to date there has also been little discussion of possible alternatives for ensuring the availability and affordability of terrorism coverage after TRIA expires.

Our report concluded Congress may benefit from an informed assessment of possible alternatives to TRIA, including both wholly private alternatives and alternatives that could involve some Government participation or action. Such an assessment could be part of Treasury's TRIA-mandated study to assess the likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after the termination of the program.

As a result, as part of the response to the TRIA-mandated study, our report recommends to the Secretary of the Treasury that it consult with the insurance industry and other interested parties and identify for Congress an array of alternatives that may exist for expanding the availability and affordability of terrorism insurance after TRIA expires. These alternatives could assist Congress during its deliberations on how best to ensure the availability and affordability of terrorism insurance after December 2005.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to questions at the appropriate time.

Chairman SHELBY. Mr. Hunter.

STATEMENT OF J. ROBERT HUNTER
DIRECTOR OF INSURANCE
CONSUMER FEDERATION OF AMERICA

Mr. HUNTER. Mr. Chairman, thank you for bringing me back to this room where, as Federal Insurance Administrator, Senator Proxmire made me feel a little bit, I am sure, like Secretary Roseboro must have felt a few minutes ago. I served as Federal Insurance Administrator under Presidents Ford and Carter, and as Texas Insurance Commissioner—and I am an actuary, so if you have any actuarial questions, give me a call.

September 11 was an awful day, as we know. The property casualty insurance paid losses from that day are now estimated to be between $30 and $35 billion before tax. After Federal tax considerations, that is about $20 billion that the industry has or will pay out from the September 11 event. To put that into perspective, the after-tax profits of the American International Group last year was $9.3 billion. The retained earnings of the property casualty insurance industry in 2000 was $65 billion. The insurers do not need free reinsurance anymore.

I bring that conclusion in part from my experience with the riot reinsurance program that I administered. The program kept insurance in the inner cities in the early 1970's when there was a great fear of writing insurance in the inner cities very similar to this situation. We charged at the Federal Insurance Administration actuarially sound premiums for reinsurance, and when the program was terminated taxpayers actually realized a profit from writing reinsurance. The private reinsurance market developed under our program because the price we charged was actuarially sound. It was not free. It is amazing how little competition you will get from the private sector when you charge zero for something.

CFA has recently published a major study of the workings of TRIA, which I have attached to my written testimony, which I assume is in the record as well. Almost all insurers rely to some degree on the terrorism models that are out there including the Insurance Services Office model. ISO is a ratemaking organization. They show that four cities have high risk of terrorist attack: New York, San Francisco, Washington, and Chicago. And that five cities have moderate risk Boston, Seattle, Los Angeles, Houston, and Philadelphia, and the rest of the country is low risk according to the models.

Terrorism insurance rates are very low in the low risk areas. For example, a $10 million building with $5 million of contents would pay only $300 to insure terrorism risk in 2005.

Chairman SHELBY. Where?

Mr. HUNTER. In the rest of the country, excluding the nine cities. In the five moderate-risk cities, the cost is $6,200 for that building, and in the four high-risk cities, the cost would be $50,000 in that $10 million building with $5 million of contents. In the high-risk cities, costs would rise to an estimated $71,500 if TRIA expired. In other words, the rate would go up about 50 percent. In the lower-risk areas the change would be very modest, and in the moderate risk areas also, only $326 more.

The private sector will cover all ISO-projected terrorism losses in all but the nine cities according to the model, except for the very unusual, nuclear and so on. Outside the nine cities there is not much risk of losses according to the ISO model. One hundred percent will be covered in the low-risk areas by the private sector in 2005. Commercial insurance buyers in most of the Nation are reluctant to buy taxpayer-backed terrorism insurance. That is no surprise. Most reluctant are the rural areas. They do not expect to use it.

We have done a lot of studies over time on why the flood insurance policies do not sell, and why earthquake insurance does not sell. I think lack of terrorism coverage is the same exact thing. People do not think it will happen to them is the primary reason. The second reason is, if it does happen, Congress is going to come along anyway and bail us out regardless of whether we buy it, so why buy it? That is a perception that research by Wharton and others shows.

Industry experts have projected that terrorism insurance losses will be modest. ISO says that the average annual losses from terrorism for all property casual insurance will be $5.75 billion a year. That is the average. To put that into perspective, the property casualty insurance premiums in 2003 were $450 billion. Those losses would be 1.3 percent of premiums. Insurers are in an excellent financial position to cover terrorism losses. They have just gone through what is called a hard market. The profits are very high and expected to remain high for several years. Now is the time, as I think was earlier said, to consider eliminating free reinsurance.

However, we do not think it is necessary to extend, but if you do there are four very quick principles that we think you should look at. First, focus on the nine cities where the risks are high. Second, increase the deductibles that insurers pay. We suggest a deductible of at least $50 billion after tax. The current deductibles are pretax.

Third, increase the share of losses that insurers pay above the deductibles. And move those higher and higher year-by-year, if you have to go forward with the program, to phase out and make sure the private sector can build capacity. And fourth, ensure that taxpayers are reimbursed for backing up terrorism losses. Also, the Treasury Department should require that insurers pay premiums for the coverage the taxpayers are providing that are actuarially sound or maybe even a little higher than actuarially sound so that the private sector can compete.

I will be happy to answer questions when the time is right.

Chairman SHELBY. Mr. Degnan.

STATEMENT OF JOHN J. DEGNAN
VICE CHAIRMAN AND CHIEF
ADMINISTRATIVE OFFICER, THE CHUBB CORPORATION
ON BEHALF OF

THE AMERICAN INSURANCE ASSOCIATION,
COUNCIL OF INSURANCE AGENTS & BROKERS,
THE FINANCIAL SERVICES ROUNDTABLE,
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA,
NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES,
NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS,
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA,
REINSURANCE ASSOCIATION OF AMERICA,
SURETY ASSOCIATION OF AMERICA, AND
UWC—STRATEGIC SERVICES ON UNEMPLOYMENT & WORKERS' COMPENSATION

Mr. DEGNAN. Thank you, Mr. Chairman. Today, I appear representing the American Insurance Association and a broad coalition of virtually every other property and casualty trade association. We have made sadly obvious to the Chairman and others on the panel that we rarely speak in our industry with one voice, but today I have the opportunity to speak with one voice for the entire P&C industry. With that one voice we urge the Congress as strongly as we can to extent TRIA now for an additional 2-year period after December 30, 2005.

I was surprised to hear Under Secretary Roseboro indicate that he had not heard that from the industry. I attended in March with many of the leaders of the P&C industry a meeting with Treasury Secretary Snow and Under Secretary Roseboro at which we strongly urged them, with as much urgency as we could convey, the need to do so this year. Doing that would allow sufficient time to assess the data from Treasury's mandated June 2005 TRIA study, and in that context a long-term solution for managing the uninsurable risk of catastrophic terrorism could be evaluated, and if feasible, developed and implemented.

Although insurance losses were hardly the most serious implication of the tragic attack of September 11, that attack did result in the most expensive insured event in U.S. history, with losses estimated to be close to $35 billion. I am proud to note that insurers responded to the September 11 claim without the benefit of a single dollar of Federal assistance. This prompt and positive response has been credited by many with stabilizing financial markets in the immediate aftermath of the attack.

September 11 awakened us all to the reality that we are in a war against terrorism. Recognizing both the new nature of terrorism risk and the destabilizing strain that tragic event placed on the private terrorism risk insurance market, Congress enacted TRIA in November 2002. While not perfect TRIA has ensured, and many of the witnesses I think share this view, market stability for our customers. Since TRIA's enactment, affordable terrorism insurance has been readily available to commercial policyholders, and TRIA has enabled billions of dollars of business transactions which were previously stalled to move forward without threatening the solvency of the commercial enterprises involved or their insurers. And it has kept Government administrative costs to a minimum.

But the TRIA cannot address the underlying systemic problems of insuring terrorism. First, terrorism risk modeling is still in its infancy. Natural catastrophe modeling does help, but unlike terrorism natural catastrophes are predictive, both of method and of frequency and of severity. Only terrorists can control those variables in a terrorist risk.

Second, terrorism is an interdependent risk. Nothing could have been done by the World Trade Center management at the time to prevent what happened on September 11 or to avoid security failures elsewhere. With terrorism, vulnerability unfortunately is measured by the weakest link in the chain.

Third, another catastrophe terrorism event could bring financial ruin to the insurance industry. Under certain event scenarios, estimated insured losses could exceed $250 billion. That level would easily exceed the industry's entire commercial capacity. Capacity that is needed, by the way, to back all commercial risks, not just catastrophic terrorism.

And finally, information necessary to evaluate terrorism risk to enable us to underwrite it often falls within the realm of sensitive intelligence data, and the insurers and policyholders simply do not have access to the classified data in the hands of the U.S. Government.

If anything is certain about the risk of terrorism is that that risk will not fade away when TRIA expires at the end of 2005. Neither war nor terrorism happens by chance. They are both premeditated. They are planned and executed with specific purpose. Terrorism today is essentially war carried out by individuals or organizations rather than sovereign nations. Because of these shared characteristics with war risk, terrorism defies normal underwriting and rating principles, limiting the ability of the private market to react.

Accordingly, the TRIA backstop continues to be vital. We urge Congress to act today to extend TRIA for 2 more years. As some witnesses have said, there is a mismatch between the annual terms of insurance policies and TRIA's end date of December 31, 2005. Annual policies written after January 1, 2005 will have a term that expires beyond the end of TRIA. As a result, unless the TRIA is extended in connection with the "make-available" extension by Treasury which we support, insurers will still have to evaluate every policy issued in 2005 as if there is no backstop. And because of State notice requirements, insurers will really have to begin informing policyholders as early as October 2004, even if the "make-available" decision is issued, that there is uncertainty with respect to terrorism coverage for a full annual period and a policy renewing after January 1, 2005.

Equally important, the backstop should be extended until the risk of catastrophic terrorism and how best to spread that risk and manage it are fully understood. As I have noted, and you have, Treasury's report to Congress is not due until just 6 months before the program is scheduled to sunset, and the analysis and development of data and sound public policy on what is an important national economic security issue should not be held hostage by a date.

In conclusion, September 11 proved that our national economy depends on a strong insurance industry. If the insurance industry were seriously compromised, all areas of the economy would suffer. TRIA's public-private partnership is working to stabilize the commercial insurance markets that underpin our free market economy in the face of a risk that remains essentially uninsurable. The aim, after all, of a terrorist is not only to hurt the insured, but also to wage war against the United States by targeting this country and its institutions. Without TRIA, a catastrophic attack could very well bring the insurance industry to its knees and significantly destabilize our economic infrastructure, achieving a primary aim of the terrorists. We simply cannot afford to let TRIA expire and leave this important measure to chance. A two-year extension is critical.

Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Nassetta, we have a vote on the floor, so if you and Mr. Dubois would briefly sum up your testimony we could move along.

**STATEMENT OF CHRISTOPHER NASSETTA
PRESIDENT AND CHIEF EXECUTIVE OFFICER,
HOST MARRIOTT CORPORATION
ON BEHALF OF
THE COALITION TO INSURE AGAINST TERRORISM**

Mr. NASSETTA. I would be happy to. Thank you, Mr. Chairman. I am here today representing the Coalition to Insure Against Terrorism, or CIAT.

I am the CEO of Host Marriott Corporation. We are the largest owner of hotels in the United States with interest in over 230 properties in 34 States and the District of Columbia. Like many other CEO's here today, since September 11 I think it is fair to say I have spent more time on insurance issues than I have in all of the years leading up to September 11. This occurred at the same time when our industry probably suffered the most catastrophic decline in operations in its recorded history.

My real involvement with terrorism insurance started on September 11 when we lost our Marriott World Trade Center Hotel and suffered significant damage to our Marriott Financial Center Hotel. More importantly, we lost 2 employees at the World Trade Center Hotel and 11 of our guests were unaccounted for. I recognized at that moment what a critical issue this was for our company, our industry, and the broader economy as I witnessed the devastation of September 11 and realized that this war on terrorism, as we hear from most involved, is going to be a war that is waged over a very long period of time.

While certainly an important issue for our company, as I mentioned, I am here representing CIAT. CIAT was formed following September 11 by a broad-based group of industry associations and companies to address the critical need for terrorism insurance. CIAT is a diverse membership group which covers private companies as well as public sector buyers of insurance. Sectors we represent include real estate, entertainment, transportation, utilities, and finance, just to name a few. As such, we are, in our view, the primary consumer of this very important insurance product.

It is fair to say, following September 11, as we have heard today, terrorism insurance was very scarce, very expensive, and we were left with inadequate protection of our existing assets. We saw a significant slowdown of development and job losses as a result of that, and of course, the negative result that this had on our economy.

My experience was that we were only able to obtain terrorism insurance at about 3.5 percent of prior levels. Our costs tripled, and it excluded biological, chemical, and radiological events. Thanks to the leadership of Congress and our President, TRIA passed in 2002 and has been a great success. Since then, costs have stabilized and capacity in the market has increased substantially.

While TRIA has been a great success by many measures, it has not been an unqualified success in the sense that to date, as you have heard, no private reinsurance market of substance has really formed for that portion of the liability that is retained by the individual insurance companies, or for biological, chemical, or radiological events, even though these perils are technically covered by TRIA. Thus all policies today exclude biological, chemical, and radiological events with the exception of workers' compensation insurance which is regulated by the States.

Some have argued even here today that we should let market forces solve the problem and that TRIA may stunt that opportunity. In my opinion, nothing is further from the truth. It is clear at this point that the insurance industry, and you are hearing from them here today, is unable to underwrite the risks currently, and certainly without TRIA we would not have any significant market.

On behalf of CIAT, I would ask you to consider two issues. One, that we urge the Treasury Secretary to extend the "make-available" date. Without that, I think hard evidence and anecdotal evidence suggest that we will not have the availability of terrorism insurance. Waiting until September is unacceptable in the sense that delay creates a lot of uncertainty in the market.

Two, we should extend the overall program with a "make-available" provision for 2 years. It is clear, as I have said and I think you have heard today, that the industry is just not prepared at this point to underwrite it. The insurance industry may never be able to underwrite it, but that is something to debate later. The increased uncertainty is ultimately going to create dislocation in the financial markets. It is going to ultimately increase the cost of capital, I think, and as a result of that, slow the economy and cause job losses. Keeping in mind that many of the insurance policies are longer than one year in length, this is not something that we are going to experience a few years from now. This is something that is very close. That uncertainty is going to have a real impact in the short-term.

I think the extension of 2 years really, as people have talked about today, allows the markets to attempt to underwrite the risk. In my humble opinion, the markets may not be able to underwrite it longer term but an extension at least allows a reasonable period of time to debate the issue on Capitol Hill of whether this is a cost our society should bear in the sense that it really is something that starts with an act of war against our way of life. But the extension, in any event, allows the time to figure out whether this can be solved with a longer-term solution.

We must ultimately protect our financial markets and our overall economy. TRIA is a critical component of protecting the economy against terrorism. It just does not seem appropriate, to me or, the many people I talked to, when we got this passed in the first instance, that is prudent to let TRIA lapse and then pick up the pieces and clean up a mess after the fact. It just does not seem to be the way we do things.

Finally, I would say it seems a bit ironic and inconsistent that through OPIC we provide terrorism insurance for investments overseas until 2007 but if we do not extend TRIA, we would not be providing that same type of insurance for acts of terrorism on our own soil.

Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Dubois, we only have 3 minutes for you. We have 3 minutes till the vote ends and I am going to have to go, so they have eaten your time up. So welcome again to the Committee. We have your written testimony in the record and if you will sum up your two or three basic parts fast.

STATEMENT OF JACQUES E. DUBOIS
CHAIRMAN AND CEO
SWISS RE AMERICA HOLDING CORPORATION

Mr. DUBOIS. Thank you, Mr. Chairman, let me do that quickly.

Swiss Re has a keen interest in this law for two reasons. We believe that U.S. terrorism risk stems in large measure from terrorist efforts to influence Government policy. As a result, we feel very strongly that Government must play a partnership role with the insurance industry in coping with these losses. I would further add that we are not optimistic that this would be temporary or could be temporary in nature.

Second, I would say that TRIA has worked. TRIA has provided protection limiting insurer losses in the event of an additional terror attack or attacks. This allows the insurance industry to perform its traditional roles in bearing risk against losses from hurricane, windstorm, floods, fire, auto, et cetera.

As a reinsurer, we are not required to provide terrorism reinsurance coverage, and for the most part we do not at this time with two exceptions. We provide partial protection to clients for the TRIA retention exposure, and we provide modest catastrophe recovery for our group life clients. Our position is that the insurance and reinsurance market is not currently prepared to absorb terrorism risk regardless of any limited improvement in modeling whatsoever. The possible losses are just too high.

Swiss Re is currently sponsoring with nine other organizations a study by the RAND Corporation aimed at assessing terrorism risk and loss potentials. What we are learning there is really horrifying. I would not want to live in the tenth city.

Chairman SHELBY. Would you furnish us a copy of that for the record, the RAND study?

Mr. DUBOIS. Yes, we will do so, sir.

In addition, Swiss Re also assisted in a study by RMS, a leading modeling organization, which also analyzed terrorism scenarios. This study found that insured losses of $55 billion are possible for workers' compensation and life insurance lines of business.

In a LOMA study, a research and education association for the life and financial services industries, a study on terrorism events, including that of a smallpox attack, indicated a possible death count of 30 million people, approximately 12 times the number of deaths in the United States annually. Just as with September 11, the possible costs of these horrific losses have not been factored into insurance prices and cannot be absorbed by the industry.

In the interest of time let me just comment that we very much support the group life insurers in seeking inclusion in the TRIA legislation. We are the largest group life reinsurer and we do not have a way to model because of the impossibility of forecasting frequency and severity, and we urge the extension of TRIA.

Thank you.

Chairman SHELBY. We are going to leave the record open for questions because of the vote on the floor. We have a number of questions. We have a number of Members of the Banking Committee that are on the Floor. They could not be here. They are in the debate there.

Gentlemen and Ms. Williams, thank you for appearing before the Committee. We think this is a very important issue.

The hearing is adjourned.

[Whereupon, at 11:51 a.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follows:]

PREPARED STATEMENT OF SENATOR CHARLES E. SCHUMER

Mr. Chairman, thank you holding this hearing today. The world is a different place than it was before September 11, 2001. New York has been profoundly affected by the horrific events of that day. The enactment of the Terrorism Risk Insurance Act has been vital to New York. It has translated into thousands of jobs and desperately needed economic activity for New York City, the region, and the entire country.

Back in 2002, Senators Dodd, Sarbanes, Reid, and I argued with our colleagues who argued that the free market would solve the issue of terrorism insurance. The Treasury and some Congressional Republicans were against the bill then and it appears they still are.

I am concerned about the consequences of not reauthorizing the Act, which I believe could be very significant and disruptive to the economy. I am not confident that the private sector will do this without governmental involvement. How can the Treasury not support reauthorization of this Act, which is a job producer and economic stimulator? We cannot let ideology stand in the way of economic revitalization.

If Treasury does not want the Act extended, tell us so. The Act has been a success for New York and for the country. We should not endanger that success by creating uncertainty and instability about the availability of terrorism insurance. I believe that the cost of this uncertainty and resulting instability is too high a price to pay. Can we as a country afford that cost if the terrorists should strike again here? I do not think we can and will do all I can to ensure against such a result.

We are not over the threat of terrorist attacks. The President has repeatedly told us that the war on terrorism is a long-term undertaking. I believe that terrorism risk insurance is a basic part of that undertaking. It will allow us to keep economic activity on track in this brave new world. The Government/private sector responsibilities in the Act will make that possible.

I know firsthand the aftermath of the September 11 attacks and hope and pray that no area in the United States will have to experience such a tragedy in the future. I believe that if such a tragedy should occur, Americans must be provided the tools with which to rebuild their lives. Terrorism insurance is one of those tools.

I look forward to hearing today's testimony and working with the Committee toward reauthorization of this important legislation.

PREPARED STATEMENT OF E. BENJAMIN NELSON

A U.S. SENATOR FROM THE STATE OF NEBRASKA

MAY 18, 2004

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before your Committee today to offer my comments on the Terrorism Risk Insurance Act that we enacted into law almost 2 years ago. I strongly supported passage of the bill at that time, and I believe that, if we begin soon, we can pass a reauthorization of that Act, and even improve it, yet this year. I recognize that may be a daunting task, but I believe we can and should act before the end of this Congress. And we need to strengthen the Act by adding coverage, with a second pool, for the group life and health carriers.

I would like to commend you, Mr. Chairman and Members of the Committee, and especially Senator Dodd, who worked so hard on passing this measure in the last Congress, for your leadership on this important issue 2 years ago—it was critical to act as we did. And I also applaud you for your leadership in revisiting the issue at this critical time.

Mr. Chairman, in the wake of the tragic events of September 11, this Nation has endured the wrenching emotional effects of the loss of life and human suffering resulting from those evil acts. The Nation's soul has been affected, forever. None of us will ever forget our grief over the human losses of that day, nor should we.

But we all can understand also the extent of economic disruption and loss which has ensued in the aftermath of that day. While it pales in comparison to the emotional costs wrought by the terrorists, the cost to our economy has been enormous. Investment has been curtailed. Construction projects have been postponed or cancelled. Jobs have been lost. Our entire economy has suffered.

But it could have been so much worse, Mr. Chairman. In the weeks and months following September 11, Congress and the President came together to provide a measure of protection for our Nation's critical economic infrastructure. Recognizing the effect that massive terrorist attacks could have on the ability of the Nation's insurance carriers to pay claims resulting from such attacks, and the difficulty in predicting such events, Congress moved to provide Federal "backstop" legislation, in effect, a guarantee that would help insurers cover excessive loses in the event of another even more catastrophic event. Unfortunately, such events are no less likely today than they were in the days, weeks, and months following September 11.

As the Government Accounting Office has recently reported, the Terrorism Risk Insurance Act has served us well since its enactment. In the troubled time after September 11, it has provided a stabilizing effect on the property and casualty industry and affordable protection for American businesses. Had we failed to provide this Federal backstop when we did, Mr. Chairman, the effect on our economy would have been disastrous. In the months following September 11, while the Congress debated whether to provide this protection, lending on commercial real estate projects in high-threat areas was severely curtailed. Disruption in the property/casualty industry loomed. Reinsurance was scarce or nonexistent. Workers' compensation programs were threatened. The banking and securities industries were adversely affected.

But following enactment of TRIA, construction projects could resume, with the assurance that catastrophic losses could be covered. Lending on commercial real estate projects could again be secured. Construction jobs returned. The economy began to right itself. Of course, there were those at the time who resisted pledging the Federal Government's backing for possible catastrophic losses. But the Congress ultimately did the right thing, recognizing that there was no alternative. The industry simply could not accurately assess the risk, and certainly could not charge premiums sufficient to adequately cover the catastrophic risks.

Critics of the legislation point out that the relatively low take-up rate is an indication that the legislation is not necessary. That criticism, I believe, is misplaced. The take-up rate is a poor measurement of the need for the Federal backstop. Commercial interests located outside of high-risk areas such as New York, Washington, Los Angeles, and other major metropolitan areas naturally do not consider the high cost of coverage to be justified, given the low risk of a terrorist attack in those areas. And the cost of coverage remains very high. But it is worth providing this protection to those who desperately need it. It is essential to our economy that commercial interests in relatively high-threat areas continue to have this coverage available.

Since enactment, there has also been criticism, Mr. Chairman, that the industry has failed to develop private solutions to the challenges presented in this new, post-September 11 environment. Of course, TRIA was originally conceived and passed as a temporary program, a bridge to a time when the risk of terrorist acts would abate, and the market could adjust accordingly. While I still believe that it may be possible, over the long-term, to achieve these goals, is there any among us who believes that the risk of another attack has diminished? It has been reported in the media that some 30 planned attacks have been thwarted by Homeland Security efforts since September 11. I hate to say it, but I believe that another attack or series of attacks on our soil is almost inevitable, and that there is a possibility that future events could make September 11 pale by comparison. It is essential that we extend the Act. It is completely unrealistic to expect that the industry can, in 2 or 3 years' time, adequately restructure itself to ensure its ability to cope with such catastrophic losses. In fact, to expect the industry to ever be able to adequately assess the risk of a major terrorism incident—where, when, how, and with what results—in the high-threat environment that we face today, is unrealistic. Only when we have won the war on terrorism will the threat abate. And who can say when that will be? And in the meantime, how can the industry assess premiums to build adequate reserves to cover what could be incomprhensible losses? In the end, it all comes down to, how do you adequately assess the risk? It is impossible, Mr. Chairman, in a terrorist environment.

We need to reauthorize TRIA. And we should do so yet this year. While I am confident that Treasury will exercise its authority to extend the make available provisions of the Act through next year, the problem with expiration of the Act at the end of 2005 begins to manifest itself at the end of this year. Policies are generally written for the term of one year. Obviously, those policies written after December 31, 2004, will extend into 2006, leaving backstop coverage unavailable for the latter part of the term of those policies.

As the Members of this Committee are aware, the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held a joint hearing with the Subcommittee on Oversight and Investigations on April 28 to begin consideration of the issue in the House. At that hearing, the Superintendent of the New York Department of Insurance, Mr. Greg Serio, expressed the strong support of the National Association of Insurance Commissioners for reauthorization this year. Mr. Chairman, I am a former insurance commissioner and former head of the NAIC, as well as a former insurance company executive, and I can certainly understand and appreciate, from a regulator's point of view, the concerns about the safety and solvency of the industry. I applaud the regulators for supporting the early reauthorization of TRIA.

I will concede, Mr. Chairman, that TRIA, as we enacted it 2 years ago, is not perfect. There were those of us who sought to include the group life industry within the coverage of the Act. I worked long and hard to include coverage for group life when we passed the first bill, and was disappointed in the determination of the Treasury that coverage under the Act would not be provided. And problems also remain for workers' compensation carriers under the law. We need to look at those issues.

Mr. Chairman, I believe we should attempt to address these shortcomings as we undertake to devise reauthorization language. I know that this approach will compound our efforts to pass legislation yet this year. But I also believe that the success of TRIA, and the continuing high-threat level over the past 2 years, may work to convince many of our reluctant colleagues of the need to act this year.

As to the question of coverage for group life insurance, it seems obvious that the concentration of risk issues which justify coverage for property and casualty carriers under the Act extend as well to group life coverage. Employers with large numbers of employees in concentrated locations need this protection if they are to continue to provide this important employee benefit. For many of America's workers, group life insurance may be the most significant protection for their families in the event of the premature loss of the family breadwinner. Group life insurance today covers nearly 160 million Americans, and represents 40 percent of all life insurance in force, $6 trillion of protection for American families. The Committee is aware, I know, that the reinsurance market for group life has also been severely disrupted, and in most cases is no longer available, or priced too high to be realistic.

And the same concentration of risk issues work severe. Difficulties in the workers' compensation area. Carriers are required by statute to provide "all risk" coverage, and thus they are now faced with the possibility of concentrated catastrophic losses which could result from nuclear, biological, chemical, or radiological attack. This has caused disruption in underwriting for workers' compensation since September 11, and those problems have not been alleviated by TRIA. We need to work with the industry as we develop reauthorization language, and we should do it this year.

Mr. Chairman, I appreciate the opportunity to give this Committee my views on this important, indeed vital, issue. I urge the Committee to move forward with all due speed in expanding coverage and reauthorizing the Terrorism Risk Insurance Act. Thank you for your consideration of my views.

PREPARED STATEMENT OF BRIAN C. ROSEBORO

UNDER SECRETARY FOR DOMESTIC FINANCE

U.S. DEPARTMENT OF THE TREASURY

MAY 18, 2004

Thank you, Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee on Banking, Housing, and Urban Affairs for this opportunity to testify today on the implementation of the Terrorism Risk Insurance Act (TRIA) of 2002.

The market for property and casualty terrorism risk insurance was significantly affected by the terrorist attacks of September 11, 2001. In the aftermath of September 11, reinsurers by and large refrained from offering coverage for property and casualty terrorism risk or offered reinsurance coverage at costs that were generally considered prohibitive. This then caused property and casualty insurers in general to respond by excluding terrorism coverage from commercial property and casualty insurance policies, leaving many American businesses exposed and uninsured. Perhaps the most notable negative impact of this development was the drag it created on businesses' ability to finance new job-creating economic activity in the midst of our economic downturn caused in part by the events of September 11.

To address this condition, Congress enacted TRIA in the fall of 2002. TRIA establishes a temporary Federal program of shared public and private compensation for insured commercial property and casualty losses resulting from acts of terrorism covered by the Act. TRIA in effect places the Federal Government in the property and casualty terrorism risk reinsurance business through December 31, 2005.

By most indications, TRIA has been successful in achieving the fundamental goal of enhancing the availability and affordability of property and casualty terrorism risk insurance, particularly for economic development purposes. No longer are heard the same level of concerns from real estate developers, for example, that new projects are on hold because financing has been frozen by a lack of terrorism risk insurance. In terms of affordability, while the information is still somewhat preliminary, accounts that we have seen indicate that premiums for terrorism risk insurance have decreased significantly throughout the early stages of TRIA and continue to do so.

Despite TRIA's apparent success, there have been widespread reports that the "take up" rates for TRIA coverage have been low, or in other words, the demand for this coverage has been low. Whether this reflects a lack of interest in terrorism risk coverage at current prices, a lack of awareness of the availability of coverage, an assessment by businesses of low terrorism loss risk, or some combination of the above will require careful study and analysis of information reflecting as comprehensive a view of markets as possible.

Treasury's Implementation of TRIA

Treasury has the chief responsibility for implementing the Federal reinsurance backstop that was established under TRIA. In broad terms, as Treasury has undertaken the overall implementation of TRIA, we have focused on five main administrative goals: Ensuring that the program was operable immediately; implementing the program in a transparent manner; relying on the State insurance laws and regulatory structure as much as possible; allowing insurers to participate in program through their normal course of business where possible; and ensuring that insurance benefits, if needed, can be provided in an expedited manner.

Perhaps the most daunting, immediate administrative task was to prioritize and undertake the actions needed to make the program operational right away. One of the key factors in this regard was that TRIA became effective immediately on November 26, 2002, when the President signed the Act into law. The instant effective date of TRIA meant that terrorism exclusions on existing insurance policies were removed and all policyholders had the ability to secure coverage for terrorism risk. In addition to the effective date, Treasury also had to address the wide range of businesses, insurance companies, and types of policies that are affected by TRIA.

To address the immediate effective date of TRIA and provide the necessary guidance to the insurance industry and others to make the program operational, Treasury's first action was to issue promptly a series of three interim guidance notices. The first interim guidance notice was issued on December 3, 2002, about 1 week after TRIA was signed into law. Other interim guidance notices were issued on December 18, 2002, and January 22, 2003. Treasury relied on the process of issuing interim guidance notices because it provided us with the ability to respond quickly to implementation issues, and to prevent confusion prior to the issuance of formal regulations. These interim guidance notices provided the basis for insurance companies to proceed with offering coverage by addressing issues such as: Compliance with TRIA's required disclosure and "make available" requirements; determining what insurers were required to participate in the program and how their deductibles would be calculated; and the scope of coverage under the program.

Even while the interim guidance process went forward we began the next step in the implementation process of preparing formal rulemakings that would incorporate and supercede our interim guidance. In general, the first rules were issued as interim final rules, as authorized in the statute, because of the immediate operational needs. The first interim final rule was issued on February 28, 2003. That rule and an interim final rule that was issued on April 18, 2003 took many of the issues that were addressed in interim guidance notices and transformed them into formal implementing regulations. Subsequent rulemakings have addressed issues associated with State residual market mechanisms, claims processing, and litigation management. Overall, Treasury has published two interim final rules and three proposed rules, and three of these rulemakings have been finalized.

It is important to stress that while we have been moving progressively through the rulemaking process, the program from the beginning has been and continues to be fully operational. These rules have been put forward as refinements to and improvements on practices and operations, but from the earliest days of the program, we have had procedures and resources ready to respond to any covered event that might arise.

In addition to the regulatory actions outlined above, Treasury has also created and staffed a Terrorism Risk Insurance Program (TRIP) office to administer the Act. Among its accomplishments, the TRIP office has developed systems to handle claims processing, payment, and auditing of claims should a covered event occur. The TRIP office has been working to provide detailed operating procedures for claims filing, processing, and payment that are separate from the claims procedures regulation. Also, the TRIP office has been consistently responding to requests for interpretation of the Act and its regulations from insurers; many of those interpretations have been made available to the general public on the TRIP website (*www.treas.gov/trip*).

TRIA created an interesting hybrid program jurisdictionally; it provides a Federal reinsurance backstop to commercial property and casualty insurance entities that are regulated almost exclusively at the State level. This type of program would likely be unmanageable without the cooperation of the State insurance regulators—cooperation among themselves and cooperation with the Federal Government. Throughout the implementation process, Treasury consulted and worked closely with the NAIC, and the NAIC's assistance has been invaluable in implementing TRIA. We look forward to continuing to work closely with the NAIC regarding Treasury's remaining responsibilities under TRIA.

Comprehensive Market Information and Analysis Requirement

An important requirement of TRIA is to implement the Act with a careful eye on market conditions and developments, and report to Congress. In particular, Treasury is required to report to Congress by June 30, 2005, on an itemized list of issues associated with the Act and its purposes. Specifically, Treasury is required to assess——

- The "effectiveness of the Program;"
- The "likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the Program;" and
- The "availability and affordability of such insurance for various policyholders, including railroads, trucking, and public transit."

Together with this analysis, Treasury is also required under TRIA to compile information on premium rates for property and casualty terrorism risk insurance.

To assist in the evaluation of the Act's effectiveness and to meet TRIA's premium information collection requirement—and to ensure that we do so with as comprehensive a view of the markets as possible—Treasury has contracted with an outside survey research firm to conduct a comprehensive survey with a nationally representative sample of policyholders and insurers. Some of the information being collected through the surveys includes the cost of terrorism risk insurance as compared to total insurance within eligible lines, basic financial data, insurance deductibles and limits for terrorism as compared to nonterrorism insurance, use of reinsurance and self insurance, and the types of risk management programs.

Each company chosen for the survey will be contacted at least twice and possibly three times (depending on its policy renewal dates) in order to capture effects of changes in TRIA's insurer deductibles in successive program years. The first survey wave collected data from 2002 and 2003. Surveys for the first wave were mailed out late in 2003 and early 2004 to over 30,000 policyholders and almost 500 insurers. A second survey wave to collect 2004 data is planned for early this fall, and the last survey wave is planned for January and February of 2005. This phased structure will allow us to move beyond snapshots and anecdotal evidence to obtain a broader and more dynamic view of the conditions in the marketplace. We believe anything less would not provide to the Secretary the full and reliable information needed to make the careful, trustworthy, and responsible evaluation called for by Congress in the statute.

The completed survey results, as well as consultations with a wide range of interested parties, will form the basis for Treasury completing by the June 30, 2005 statutory deadline its report to Congress on the effectiveness of TRIA and the capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the program.

Determination on Extending the "Make Available" Requirement

The Secretary of the Treasury is required by TRIA to determine by September 1, 2004, whether to extend the "make available" provisions into the third year of the program (that is, through December 31, 2005). The "make available" provisions of TRIA require that, from the date of enactment (November 26, 2002) through the last day of the second year of the program (December 31, 2004), each insurer must make available, in all of its commercial property and casualty insurance policies, coverage for insured losses under the Act. In this regard, TRIA also requires that such insurance coverage must not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism.

TRIA requires that Treasury's determination on whether to extend the "make available" requirements through the third year of the program be based on the same statutory factors described above that are to be considered in Treasury's overall study of the effectiveness of TRIA.

Treasury is now developing a base of information from which the Secretary can make this required determination, consistent with the terms of the Act. As part of the information gathering process, on April 29, 2004, Treasury submitted to the *Federal Register* for publication a request for comments regarding the Secretary's determination of whether to extend the "make available" requirements of the Act into the third year of the program. Comments will be accepted through June 4, 2004. We encourage anyone who has views on this question to respond to this request for comments with as much detail as they can provide.

In making this determination, however, while examining similar issues as those outlined for the larger examination due by June 2005, Treasury will be looking at those issues with the specific, narrow focus of the "make available" question, and with the use of much less information than will be available for the larger, broader study. Therefore, each examination will be conducted independently of the other.

Conclusion

We must all remember that the basic goal of TRIA was to develop a temporary backstop for property and casualty terrorism risk insurance so that private markets would have a chance to adjust. We encourage insurance companies, state insurance regulators, other financial services providers, and other interested parties to think creatively in this regard, and to consider what methods can be employed to allow for broader private sector involvement in the market for managing property and casualty terrorism risk. Treasury looks forward to completing our review of the effectiveness of TRIA and considering the many complicated issues presented to us in a thorough manner with the best information that can be obtained. Our obligations to the taxpayers, and the need for the long-term health and vitality of our financial markets, require nothing less.

In summary, while we hope that we will never be called upon to trigger coverage under TRIA, the program stands ready today—as it has from its earliest days—to meet its responsibilities. The extensive work done by Treasury in developing the basic framework of TRIA through interim guidance notices and regulations, the proposed claims regulations, the drafting of claims forms and review with industry organizations and the NAIC, and contingency procurement plans, all have contributed to an effective program that the Treasury will continue to refine over the life of the program. We look forward to moving forward with the implementation process and evaluating the effectiveness of the program in the weeks and months ahead.

PREPARED STATEMENT OF DONNA LEE WILLIAMS

DELAWARE COMMISSIONER OF INSURANCE

ON BEHALF OF THE

NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

MAY, 18, 2004

Introduction

My name is Donna Lee Williams. I am the Commissioner of Insurance for the State of Delaware, and this year I am serving as Chair of the Terrorism Insurance Implementation Working Group of the National Association of Insurance Commissioners (NAIC). Speaking for myself and my fellow insurance commissioners, we appreciate the opportunity to testify regarding the role of the Federal Government in making sure that insurance against acts of terrorism remains available to American consumers and businesses.

Today, I want to make three basic points:

- First, there is still a need for the Federal Government to provide appropriate financial back-up to the private insurance market in order to assure that segments of our Nation's economy do not falter due to a lack of insurance coverage for terrorism. The insurance marketplace is not yet ready to take on the risk of providing coverage for acts of terrorism on its own.
- Second, the Treasury Department should extend the "make available" requirements in TRIA so that businesses across America will know they can purchase the terrorism insurance coverage they need to sustain a healthy economy.
- Third, Congress should act this year to extend coverage under the Terrorism Risk Insurance Program (TRIP), or enact a comparable Federal backstop for acts of terrorism, at least through 2006 because the commercial insurance markets are not yet prepared to underwrite sufficient terrorism coverage without a Federal backstop.

Following enactment of the Terrorism Risk Insurance Act (TRIA), the NAIC appointed a Terrorism Insurance Implementation Working Group of State regulators that has worked closely with the Treasury Department to successfully implement the Act's provisions, as well as to monitor the impact it has had on the insurance marketplace. Although we observe that the take-up rate for terrorism insurance coverage mandated under TRIA has not been widespread, coverage is available for those businesses and industries that want to purchase it. We believe the presence of the Federal backstop has provided a measure of comfort to the insurance industry, and has encouraged insurers to offer coverage for acts of terrorism that might not have considered otherwise in the wake of the tragic events of September 11.

The NAIC's Terrorism Insurance Implementation Working Group believes there are two ways that Congress can help to continue the progress that has been made in restoring the market for terrorism insurance. The first is to encourage the Secretary of the Treasury to make an early determination that he will impose the "make available" requirement in Section 103(c)(2) of TRIA to all participating insurers for the third year of the Terrorism Risk Insurance Program (TRIP). The second is for Congress to act this year to extend the expiration date contained in TRIA Section 108(a) to a future date that is consistent with the business cycle for terrorism insurance renewals.

Congress Should Extend the "Make Available" Requirement

Insurance regulators believe that extending the present "make available" requirement in TRIA through 2005 will help ensure marketplace stability by continuing the availability of terrorism insurance in all parts of the United States. If insurers are not required to offer coverage, areas that face low risk of losses from acts of terrorism would probably experience little disruption. However, those areas of our Nation and prominent cities with attractive targets for terrorist activity might face availability and affordability problems. This would have a negative impact on their local and regional economies, particularly real estate development.

During the first week of May 2004, insurance regulators began receiving contingency filings from Insurance Services Office, Inc., the Nation's largest insurance advisory organization. In the event Congress does not extend the TRIA program this year, these policy form filings would reinstate terrorism coverage limitations that were in effect prior to TRIA's enactment for any policies written for coverage that extends into 2006. In addition to protecting insurers from additional terrorism liability, these filings demonstrate the insurance industry is not willing to assume the risk of terrorism losses by themselves at this time.

The NAIC's Terrorism Insurance Implementation Working Group believes TRIA's "make available" requirement has contributed to the overall effectiveness of the program during its first 2 years. American businesses—both large and small—have been offered choices they might not otherwise have had. Through the "make available" provision, TRIA has given them the opportunity to make an informed choice regarding the purchase of coverage for acts of terrorism.

There are many who believe that the U.S. economy remains vulnerable to terrorist attack. This is evidenced by an increased take-up rate for terrorism coverage observed in a recent survey conducted by Marsh, Inc. In its fourth quarter 2003 survey, Marsh found that 32.7 percent of companies surveyed purchased terrorism coverage, compared with 23.5 percent in the second quarter and 26.0 percent in the third quarter.

One of the elements the Treasury Department is required to consider is the capacity of the insurance industry to accept the risk of losses from acts of terrorism. Insurance capacity is generally measured by determining the amount of capital and surplus available to insurers to support their writings. Using that measure, NAIC data shows 2003 was a profitable year for property and casualty insurers, with aggregated policyholder surplus increasing approximately 26 percent to $375 billion. It should be noted however, that policyholder surplus declined each year from 1999 to 2002, and the $375 billion figure is only 4.3 percent higher than the $360 billion in policyholder surplus held in 1999. Furthermore, less than half of those funds are used to support commercial lines writings. As part of considering whether the insurance industry has sufficient capacity to underwrite the risk of terrorism losses, the Treasury Department must consider whether the industry is willing to put its capital at risk. We believe the answer is no.

Insurers and the marketplace at large are finding it very difficult to accurately price coverage for acts of terrorism. Unknown frequency, coupled with the potential for severe losses, makes coverage for acts of terrorism one that insurers might choose to avoid if given the opportunity. Until insurers and their reinsurers become more comfortable that Government efforts are adequate to protect citizens from terrorist acts, or at least become more predictable than they are today, they will be reluctant to accept complete risk transfers from American businesses. In particular, those businesses viewed by insurers as having a greater risk of terrorism losses will have trouble finding insurance.

Consequently, the NAIC's Terrorism Insurance Implementation Working Group urges the Treasury Department to extend the "make available" requirement into Program Year Three of TRIA. This action will help avoid market disruptions which might otherwise occur, and will ensure the insurance market's continued role supporting economic development.

Congress Should Extend the Terrorism Risk Insurance Program

The NAIC urges action by Congress this year on a Federal solution to ensure continued marketplace stability when TRIA expires at the end of 2005. Because some terrorism risks are largely uninsurable without a financial backstop, State regulators are very concerned that significant market disruptions will develop before TRIA's expiration. This is due in large part to the deadlines contained in TRIA, which do not match the business cycle for insurance renewals.

The commercial insurance business cycle operates in such a way that insurers and their policyholders will be required to make decisions as early as September 2004 regarding coverage well into 2006. At present, annual policy renewals with effective dates of January 2, 2005 or later must contemplate there will be no Federal backstop for any losses occurring in 2006. For this reason, State insurance regulators anticipate widespread insistence by insurers that conditional policy exclusions for terrorism coverage be included in renewal policies starting later this year. This is the same situation we encountered in the aftermath of September 11, which prompted enactment of TRIA.

To address this situation, Congress could simply change one line of TRIA. If Section 108(a) were changed to read "The Program shall terminate on December 31, 2007," then Congress would be able to receive the report from the Treasury on June 30, 2005, and would thus have roughly 15 months to digest and debate the future Federal role related to acts of terrorism before reaching another milestone for insurers and American businesses.

An alternative to extending the expiration date of TRIA would be to extend the coverage period in TRIA without extending the actual effective date in the law. This could be accomplished by amending Section 108(a) as follows: "The Program shall terminate on December 31, 2005, *however, the Program shall continue to provide shared public and private compensation for insured losses resulting from acts of terrorism for policies or contracts issued or renewed before December 31, 2005, until the policy expiration date or 1 year from their inception or renewal date, whichever is less."*

Another alternative is to develop a different type of Federal backstop for acts of terrorism that provides some form of funding for the risk of losses resulting from acts of terrorism.

The NAIC stands ready to assist Congress in developing an appropriate method for continuing the Federal terrorism reinsurance backstop.

Workers' Compensation and Group Life Insurance

There are two major types of insurance that cause insurers special concern about whether they can continue to underwrite them without some form of assistance from the Federal Government. The first is workers' compensation, which is a property-casualty product that provides coverage for work-related injuries and illness. It covers lost wages, provides unlimited medical benefits and, in most States, provides rehabilitation benefits to get injured workers back on the job. In the event of death on the job, worker's compensation provides a monetary death benefit to the surviving spouse and children. It also provides employers with liability coverage if an employee pursues legal action against an employer in court. Workers' compensation is currently included under TRIA.

State laws do not allow an insurer to exclude or limit worker's compensation coverage, except as permitted by State law. As a result, an insurer underwriting this risk without adequate reinsurance is subject to a large potential loss if there are a significant number of employees at a single location. The American Academy of Actuaries estimates that "a modest-sized insured with 200 employees could easily generate a terrorism related event of $50 million. This presumes death of all employees and typical death benefit of $250,000 per employee.[1]"

The second type of coverage causing insurers special concern is one that is not currently included in TRIA—namely group life insurance. Like workers' compensa-

[1] American Academy of Actuaries, P/C Extreme Events Committee May 4, 2004 Report, P/C Terrorism Coverage: Where Do We Go Post-Terrorism Risk Insurance Act?, Page 14.

tion, this insurance coverage is vulnerable to risk concentration problems. For example, if a business has 1,000 employees at a given location, the pricing employed by life insurers for group products probably assumes that three or four employees might die in a given year. If instead, a location with 1,000 employees is hit by a terror attack and all of them die, the insurer has an enormous financial exposure from a single occurrence.

Unlike workers' compensation, there is no statutory requirement for group life that prohibits an insurer from limiting available coverage for acts of terrorism in some fashion. However, the employer, the insurer, the insurance industry in general, and the American economy would suffer if an insurer is only able to pay a fraction of the policy face amount in a mass casualty situation. Furthermore, State insurance regulators are not inclined to approve exclusionary or limiting language in those States that have approval authority over the wording in group life insurance contracts. Although there is some level of private reinsurance available for group life coverage, it is not sufficient to cover a catastrophic terrorism loss situation. While the NAIC has not taken on formal position on whether group life should be included in TRIA or another form of Federal backstop, I wanted to alert you that regulators have heard these concerns expressed by group life insurance underwriters.

Conclusion

We strongly urge Congressional action to extend TRIA this year, or enact an alternative form of Federal backstop for acts of terrorism, in order to avoid market disruptions likely to occur in the absence of a Federal backstop program. Such action will ensure the insurance market's continued role supporting economic development. In addition, it will allow Congress adequate time to fully evaluate the Treasury Department's June 2005 report and recommendations.

United States General Accounting Office

GAO

Testimony

Before the Committee on Banking, Housing and Urban Affairs, United States Senate

For Release on Delivery
Expected at 10:00 a.m. EDT
Tuesday, May 18, 2004

TERRORISM INSURANCE

Effects of the Terrorism Risk Insurance Act of 2002

Statement of Richard J. Hillman, Director
Financial Markets and Community Investment

GAO Accountability * Integrity * Reliability

GAO-04-806T

GAO
Accountability • Integrity • Reliability

Highlights

Highlights of GAO-04-806T, a testimony before the Senate Committee on Banking, Housing, and Urban Affairs.

Why GAO Did This Study

After the terrorist attacks of September 11, 2001, insurance coverage for terrorism largely disappeared. Congress passed the Terrorism Risk Insurance Act (TRIA) in 2002 to help commercial property-casualty policyholders obtain terrorism insurance and give the insurance industry time to develop mechanisms to provide such insurance after the act expires on December 31, 2005. Under TRIA, the Department of Treasury (Treasury) caps insurer liability and would process claims and reimburse insurers for a large share of losses from terrorist acts that Treasury certified as meeting certain criteria. As Treasury and industry participants have operated under TRIA for more than a year, GAO was asked to assess Treasury's progress in implementing TRIA and describe how TRIA affected the terrorism insurance market.

What GAO Recommends

GAO recommends that the Secretary of the Treasury, as part of Treasury's study of the effectiveness of TRIA and after consultation with insurance industry participants, identify for Congress alternatives that may exist for expanding the availability and affordability of terrorism insurance after TRIA expires. These alternatives could assist Congress during deliberations on the insurance industry's capacity to provide terrorism insurance.

www.gao.gov/cgi-bin/getrpt?GAO-04-806T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Richard Hillman at 202-512-8678, hillmanr@gao.gov.

May 18, 2004

TERRORISM INSURANCE

Effects of the Terrorism Risk Insurance Act of 2002

What GAO Found

Treasury and industry participants have made significant progress in implementing TRIA to date, although Treasury has important actions to complete in order to comply with its responsibilities under TRIA. Treasury has issued regulations on TRIA, created and staffed the Terrorism Risk Insurance Program office, and begun mandated studies and data collection efforts. However, Treasury has not yet made a decision on whether to extend the mandate that insurers "make available" terrorism coverage, using terms not differing materially from other coverage, for policies issued or renewed in 2005. Treasury's ongoing studies and data collection efforts will provide further insight into TRIA's effectiveness.

TRIA has enhanced the availability of terrorism insurance for commercial policyholders, largely fulfilling a principal objective of the legislation. In particular, TRIA has benefited commercial policyholders in major metropolitan areas perceived to be at greater risk for a terrorist attack, largely because of the requirement in TRIA that insurers offer coverage for terrorism. Prior to TRIA, GAO reported concern that some development projects had already been delayed or cancelled because of the unavailability of insurance and continued fears that other projects also would be adversely impacted. GAO also conveyed the widespread concern that general economic growth and development could be slowed by a lack of available terrorism insurance. Largely because of TRIA, these problems no longer appear to be major concerns.

Despite increased availability of coverage, limited industry data suggest that most commercial policyholders are not buying terrorism insurance, perhaps because they perceive their risk of losses from a terrorist act as being relatively low. The potential negative effects of low purchase rates, in combination with the probability that those most likely to be the targets of terrorist attacks may also be the ones most likely to have purchased coverage, would become evident only in the aftermath of a terrorist attack. Such negative effects could include more difficult economic recovery for businesses without terrorism coverage or potentially significant financial problems for insurers. Moreover, those that have purchased terrorism insurance may still be exposed to significant risks that have been excluded by insurance companies, such as nuclear, biological, or chemical events. Finally, although insurers and some reinsurers have cautiously reentered the terrorism risk market to cover insurers' remaining exposures, industry sources indicated no progress to date toward finding a reliable method for pricing terrorism insurance and little movement toward any mechanism that would enable insurers to provide terrorism insurance to businesses without government involvement.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss our report on the implementation of the Terrorism Risk Insurance Act of 2002 (TRIA) and the act's impact on the terrorism insurance market and, more generally, the economy.[1] The terrorist attacks of September 11, 2001, drastically changed the way insurers viewed the risk of terrorism. An industry that had considered the risk of terrorism so low that it did not identify or price terrorism risk separate from property and casualty coverage will ultimately pay approximately $40 billion for losses arising from September 11, according to industry experts. Responding to terrorism risk after September 11, reinsurers began excluding terrorism from coverage as contracts between reinsurers and insurers came up for renewal.[2] Without reinsurance, insurers retained greater levels of risks than they could responsibly carry, and their reaction was to exclude these risks from commercial policies as they were renewed. In short, believing that neither the frequency nor magnitude of terrorism losses could be estimated, insurance companies withdrew from the market.

In the aftermath of September 11, we reported that terrorism insurance was disappearing in the marketplace, particularly for large businesses and those perceived to be at some risk.[3] We also reported significant concern that some development projects had already been delayed or cancelled because of the unavailability of insurance and fears that others would follow. Furthermore, there was widespread concern that general economic growth and development would be slowed by a lack of insurance availability and uncertainty in the marketplace. Because of concerns about the lack of available and affordable terrorism insurance,

[1] U.S. General Accounting Office, ***Terrorism Insurance: Implementation of the Terrorism Risk Insurance Act of 2002***, GAO-04-307 (Washington, D.C.: Apr. 23, 2004), and ***Terrorism Insurance: Effects of the Terrorism Risk Insurance Act of 2002***, GAO-04-720T (Washington, D.C.: Apr. 28, 2004).

[2] Reinsurance is a mechanism that insurance companies routinely use to spread risk associated with insurance policies. Simply put, it is insurance for insurance companies. Reinsurance is a normal business practice that satisfies a number of needs in the insurance marketplace, including the need to expand capacity and obtain protection against potential catastrophes.

[3] U.S. General Accounting Office, ***Terrorism Insurance: Alternative Programs for Protecting Insurance Consumers***, GAO-02-199T (Washington, D.C.: Oct. 24, 2001), and ***Terrorism Insurance: Rising Uninsured Exposure to Attacks Heightens Potential Economic Vulnerabilities***, GAO-02-472T (Washington, D.C.: Feb. 27, 2002).

Congress passed TRIA, which took effect on November 26, 2002. TRIA is currently scheduled to expire at the end of 2005.

Our report on the implementation of TRIA has two objectives. First, we describe the progress made by the Department of the Treasury (Treasury) and insurance industry participants in implementing TRIA. Second, we discuss the changes in the market for terrorism insurance coverage under TRIA. As requested, my statement today discusses both of these objectives. Additionally, I have included an appendix to this statement that provides background information on TRIA.

In summary, Treasury and industry participants have made significant progress in implementing TRIA to date, although Treasury has important actions to complete in order to fully comply with its responsibilities under TRIA. Treasury's progress includes issuing regulations on TRIA, staffing the Terrorism Risk Insurance Program (TRIP) office, and beginning mandated studies and data collection efforts. For example, in compliance with one such study, Treasury decided not to extend TRIA to group life based on its determination that insurers had continued to provide group life coverage, although the availability of reinsurance was reduced. Treasury also issued proposed rules defining a framework for the claims process and litigation management under TRIA. Additionally, Treasury recently hired a contractor to provide claims payment services, according to a Treasury official. However, insurers have expressed reservations about Treasury's implementation of TRIA. Specifically, insurers are concerned about the potential length of time it may take for the Secretary of the Treasury to certify a terrorist event, potential inefficiencies and time lags in processing and paying claims once an event is certified, and TRIA's impending expiration at the end of 2005.[4] The industry has also expressed concern about the timing of Treasury's pending decision to extend the "make available" requirement to policies issued or renewed in 2005.[5]

[4]TRIA provides that the Secretary of the Treasury, in concurrence with the Secretary of State and the Attorney General of the United States, shall determine whether an event should be certified as an act of terrorism, based on certain criteria. For example, "an individual or individuals acting on behalf of any foreign person or foreign interest" must commit the act. Under TRIA, insurers can claim reimbursement only for losses in events thus certified. See Appendix I for more information.

[5]TRIA defines "make available" to mean that the coverage must be offered for insured losses arising from terrorist events and that coverage not differ materially from the terms, amounts, and limitations applicable to coverage for losses arising from other types of events.

TRIA has largely achieved Congress's first goal—to ensure that business activity did not suffer materially from a lack of available terrorism insurance. Since TRIA was enacted in November 2002, terrorism insurance generally has been available to businesses; however, most commercial policyholders are not buying terrorism coverage. According to insurance industry experts, purchase rates have been higher in areas considered to be at high risk of another terrorist attack. Many policyholders with businesses or properties not located in perceived high-risk locations may not be buying coverage because they view any price for terrorism insurance as high relative to their perceived risk exposure. Industry experts view overall low purchase rates in combination with a high concentration of purchases in areas thought to be most at risk as increasing the potential for negative effects should a terrorist event occur—either making economic recovery more difficult for those not insured or causing financial problems for insurers with many policies in the affected area. Further, those that have bought terrorism insurance remain exposed to significant perils because insurers have broadened longstanding policy exclusions for nuclear, biological, and chemical (NBC) events. Finally, Congress' second key goal in establishing TRIA—to give private industry a transitional period during which it could begin pricing terrorism insurance and develop ways to cover losses after TRIA expires has not yet been achieved. Industry sources indicated that under TRIA, insurance market participants have made no progress to date toward the development of reliable methods for pricing terrorism risks and little movement toward any mechanism that would enable insurers to provide terrorism insurance to businesses without government involvement.

In conducting our work, we reviewed and analyzed relevant information concerning state legislation and publicly available and proprietary industry data and studies on the terrorism insurance market. We interviewed officials at Treasury, the National Association of Insurance Commissioners (NAIC), and state insurance regulators from six states with high insurance sales volumes. We also interviewed representatives of insurance companies, reinsurance companies, brokers for insurance and reinsurance companies, industry associations, property owners and developers, and insurance filing services and credit rating agencies.[6] In our discussions with these organizations, we endeavored to gain an understanding of their experience in implementing TRIA requirements, obtain their views on the effects of TRIA on the terrorism insurance market, and identify

[6]Filing services perform many services for insurance companies, including submitting to state insurance regulators the documents required to sell a line of insurance.

developments within the industry to address terrorism risks after TRIA expires. We conducted this work in Chicago, New York City, and Washington, D.C., from January 2003 through April 2004 in accordance with generally accepted government auditing standards.

Treasury and Insurers Have Made Progress in Implementing TRIA, although Important Work Remains

More than a year after TRIA's enactment, Treasury and insurance industry participants have made progress in implementing and complying with its provisions, although Treasury has yet to fully implement the 3-year program. Treasury has issued regulations (final rules) to guide insurance market participants, fully staffed the TRIP office, and begun collecting data and performing studies mandated by TRIA. For example, Treasury complied with a mandate to collect and assess data on the availability of group life insurance and reinsurance; based on that data, Treasury determined that group life would not be covered by TRIA. However, Treasury has yet to make the claims payment function fully operational, although it has recently hired contractors to perform claims payment functions. Moreover, even though the act does not require Treasury to make a decision about whether to extend the "make available" requirement through 2005 until September of this year, some insurers expressed concerns about whether such a late decision would allow them sufficient time to make and implement changes to policy rates and terms. Additionally, insurers have voiced concerns about the time Treasury might take to certify an act of terrorism as eligible for reimbursement under TRIA and pay claims after an act was certified. Finally, as TRIA's midpoint nears, many insurers and other market participants are concerned whether TRIA will be extended or not and the timing of such a decision.

Treasury Has Issued Regulations, Staffed the TRIP Office, and Begun Studies and Data Collection Efforts

To implement TRIA and make TRIP functional, Treasury has taken numerous regulatory and administrative actions that include rulemaking, staffing a program office, and collecting and analyzing data. To date, Treasury has issued several final and proposed rules to implement TRIA; these rules were preceded by four sets of interim guidance issued between December 2002 and March 2003 to address time-sensitive requirements. As of March 1, 2004, Treasury had issued three final rules that provided uniform definitions of TRIA terms, explained disclosure (that is, notification to policyholder) requirements, and determined which insurers were subject to TRIA. Currently, Treasury is soliciting public comments on additional proposed rules addressing claims processes and litigation management issues. Also, as of September 2003 Treasury had fully staffed the TRIP office. The office develops and oversees the operational aspects of TRIA, which encompass claims management—processing, review, and payment—and auditing functions. Staff will also oversee operations performed by the contractors that actually pay claims and audit insurers that have filed claims. Additionally, TRIP staff perform ongoing work such as issuing interpretive letters in response to questions submitted by the public and educating regulators, industry participants and the public about TRIA provisions.

Treasury completed a TRIA-mandated study on group life insurance and has begun other mandated studies and data collection efforts. Specifically, TRIA mandated that Treasury provide information to Congress in four areas: (1) the effects of terrorism on the availability of group life insurance, (2) the effects of terrorism on the availability of life and other lines of insurance, (3) annual data on premium rates, and (4) the effectiveness of TRIA. After Treasury completed an assessment of the availability of group life insurance and reinsurance, it decided not to make group life insurance subject to TRIA because it found that insurers had continued to provide group life coverage, although the availability of reinsurance was reduced.[7] Treasury has not yet reported to Congress the results of a mandated study concerning the effects of terrorism on the availability of life and other lines of insurance. The study was to have been completed by August 2003, but as of March 2004 the report had not been issued. Also, in November 2003 and January 2004, Treasury began sending surveys to buyers and sellers, respectively, of insurance to collect data on annual premium rates as well as other information for the study that will assess the effectiveness of TRIA.

Treasury Has Tasks to Complete before TRIA Can Be Fully Implemented

Before TRIA will be fully implemented, Treasury has to make certain decisions and make additional TRIP functions operational. As of April 2004, Treasury had not yet decided whether to extend the "make available" requirement to policies issued or renewed in 2005. TRIA gave Treasury until September 1, 2004, to decide if the "make available" requirement should be extended for policies issued or renewed in 2005, the third and final year of the act. Treasury did clarify in a press release that the "make available" requirement for annual policies issued or renewed in 2004

[7] According to life insurance experts, life insurers have continued to sell group life policies in order to maintain customer relations that would be difficult to reestablish if the coverage were discontinued. Additionally, life insurance experts noted that business from other lines of insurance would be lost if insurers were to discontinue group life, which is typically sold as part of a package with disability and medical coverage.

extends until the policy expiration date, even though the coverage period extends into 2005.

In addition, Treasury has not fully established a claims processing and payment structure. Treasury has issued a proposed rule that would establish an initial framework for the claims process, which includes procedural and recordkeeping requirements for insurers. However, the actual claims processing and payment function is not fully operational. A Treasury official said it has recently hired a contractor that would perform payment functions in the aftermath of a terrorist attack, but has not yet written regulations to cover the latter stages of the claims process such as adjusting over- and underpayments or hired a separate contractor to review claims and audit insurers after an event to ensure that underlying documents adequately support the claims paid by Treasury. Treasury officials anticipate awarding this audit and review contract in the fourth quarter of fiscal year 2004.

Insurers Have Expressed Some Concerns Related to TRIA's Implementation

Insurers have expressed some concerns about Treasury's implementation of TRIA. Insurers are concerned that Treasury has not already made a decision about extending the "make available" requirement through 2005. They are also concerned about the potential length of time it may take for the Secretary of the Treasury to certify a terrorist event, potential inefficiencies and time lags in processing and paying claims once an event is certified, and the issue of TRIA expiration. As discussed already, TRIA gives Treasury until September 2004 to make a decision about the "make available" requirement for policies issued or renewed in 2005. Insurers have stated that this deadline does not give them enough time to make underwriting decisions and evaluate and possibly revise prices and terms, actions they normally would want to undertake in mid-2004. Moreover, in most states insurers will have to obtain regulatory approval for such changes because TRIA's preemption of the states' authority to approve insurance policy rates and conditions expired on December 31, 2003. Thus, insurers are concerned that delay of Treasury's announcement on the "make available" extension until the legal deadline may cost both companies and policyholders money because policy changes will not be implemented in time to issue or renew policies.

Insurers are also concerned that delays in the payment of claims by Treasury, whether because of the length of time taken to certify that an act of terrorism met the requirements for federal reimbursement or to process and pay claims, might seriously impact insurer cash flows or, in certain circumstances, solvency. While TRIA does not specify the length of time available for determining whether an event meets the criteria for certification, an NAIC official told us that insurers are bound by law and regulations in most states to pay claims in a timely manner. As a result, an insurer may have to pay policyholder claims in full while still awaiting a certification decision, which could create a cash flow problem for insurers. Insurers identified the anthrax letter incidents as an example where law enforcement officials still have not identified the source, whether foreign or domestic, more than 2 years after the incidents. Moreover, if Treasury decided not to certify an event after insurers had already paid policyholder claims, some insurers could become insolvent. Unless the policyholder had paid for coverage of all terrorist events—including those caused by domestic terrorists, which would be excluded from reimbursement under TRIA—insurers would have paid for losses for which they had collected no premium. An NAIC official explained that insurers would have no way to recover payments already made to policyholders for losses associated with the event other than to seek remedies through the courts. Treasury officials have said that they understand the difficulties facing insurers but cannot impose a time frame on the certification process because it could involve complex fact-finding processes. To facilitate the certification process, Treasury has met with relevant individuals within the Department of Justice and the Department of State to discuss their roles in the certification process. Insurers are similarly concerned that the length of time Treasury may take to process and pay claims could impact insurers' cash flow. In response to this concern, Treasury has decided to use electronic fund transfers to insurer's accounts to speed reimbursement to insurers with approved claims. Treasury expects this method could speed payment of claims and reduce potential cash flow problems for insurers.

Finally, insurance industry officials are worried that uncertainty about the extension of TRIA past its stated expiration date of December 2005 would impede their business and planning processes. Although TRIA does not contain any specific extension provisions, industry participants are concerned that a late decision on whether or not to extend TRIA would deny them the time needed to tailor business operations and plans to an insurance environment that either would or would not contain TRIA.

Although Available, Few Are Buying Terrorism Insurance and the Industry Has Made Little Progress Toward Post-TRIA Coverage

While TRIA has improved the availability of terrorism insurance, particularly for high-risk properties in major metropolitan areas, most commercial policyholders are not buying the coverage. Limited industry data suggest that 10–30 percent of commercial policyholders are purchasing terrorism insurance, perhaps because most policyholders perceive themselves at relatively low risk for a terrorist event. Some industry experts are concerned that those most at risk from terrorism are generally the ones buying terrorism insurance. In combination with low purchase rates, these conditions could result in uninsured losses for those businesses without terrorism coverage or cause financial problems for insurers, should a terrorist event occur. Moreover, even policyholders who have purchased terrorism insurance may remain uninsured for significant risks arising from certified terrorist events—that is, those meeting statutory criteria for reimbursement under TRIA—such as those involving NBC agents or radioactive contamination. Finally, although insurers and some reinsurers have cautiously reentered the terrorism risk market, insurance industry participants have made little progress toward developing a mechanism that could permit the commercial insurance market to resume providing terrorism coverage without a government backstop.

TRIA Has Improved the Availability of Terrorism Insurance, Particularly for Some High-Risk Policyholders

TRIA has improved the availability of terrorism insurance, especially for some high-risk policyholders. According to insurance and risk management experts, these were the policyholders who had difficulty finding coverage before TRIA. TRIA requires that insurers "make available" coverage for terrorism on terms not differing materially from other coverage. Largely because of this requirement, terrorism insurance has been widely available, even for development projects in high-risk areas of the country. Although industry data on policyholder characteristics are limited and cannot be generalized to all policyholders in the United States, risk management and real estate representatives generally agree that after TRIA was passed, policyholders—including borrowers obtaining mortgages for "trophy" properties, owners and developers of high-risk properties in major city centers, and those in or near "trophy" properties—were able to purchase terrorism insurance.

Additionally, TRIA contributed to better credit ratings for some commercial mortgage-backed securities. For example, prior to TRIA's passage, the credit ratings of certain mortgage-backed securities, in which the underlying collateral consisted of a single high-risk commercial property, were downgraded because the property lacked or had inadequate terrorism insurance. The credit ratings for other types of mortgage-backed securities, in which the underlying assets were pools of many types of commercial properties, were also downgraded but not to the same extent because the number and variety of properties in the pool diversified their risk of terrorism. Because TRIA made terrorism insurance available for the underlying assets, thus reducing the risk of losses from terrorist events, it improved the overall credit ratings of mortgage-backed securities, particularly single-asset mortgage-backed securities. Credit ratings affect investment decisions that revolve around factors such as interest rates because higher credit ratings result in lower costs of capital. According to an industry expert, investors use credit ratings as guidance when evaluating the risk of mortgage-backed securities for investment purposes. Higher credit ratings reflect lower credit risks. The typical investor response to lower credit risks is to accept lower returns, thereby reducing the cost of capital, which translates into lower interest rates for the borrower.

To the extent that the widespread availability of terrorism insurance is a result of TRIA's "make available" requirement, Treasury's decision on whether to extend the requirement to year three of the program is vitally important. While TRIA has ensured the availability of terrorism insurance, we have little quantitative information on the prices charged for this insurance. Treasury is engaged in gathering data through surveys that should provide useful information about terrorism insurance prices. TRIA requires that they make the information available to Congress upon request. In addition, TRIA also requires Treasury to assess the effectiveness of the act and evaluate the capacity of the industry to offer terrorism insurance after its expiration. This report is to be delivered to Congress no later than June 30, 2005.

Most Policyholders Have Not Bought Terrorism Insurance

Although TRIA improved the availability of terrorism insurance, relatively few policyholders have purchased terrorism coverage. We testified previously that prior to September 11, 2001, policyholders enjoyed "free" coverage for terrorism risks because insurers believed that this risk was so low that they provided the coverage without additional premiums as part of the policyholder's general property insurance policy. After September 11, prices for coverage increased rapidly and, in some cases, insurance became very difficult to find at any price. Although a purpose of TRIA is to make terrorism insurance available and affordable, the act does not specify a price structure.

However, experts in the insurance industry generally agree that after the passage of TRIA, low-risk policyholders (for example, those not in major urban centers) received relatively low-priced offers for terrorism insurance compared to high-risk policyholders, and some policyholders received terrorism coverage without additional premium charges.[8] Yet according to insurance experts, despite low premiums, many businesses (especially those not in "target" localities or industries) did not buy terrorism insurance. Some simply may not have perceived themselves at risk from terrorist events and considered terrorism insurance, even at low premiums (relative to high-risk areas), a bad investment.[9] According to insurance sources, other policyholders may have deferred their decision to buy terrorism insurance until their policy renewal date.

Some industry experts have voiced concerns that low purchase rates may indicate adverse selection—where those at the most risk from terrorism are generally the only ones buying terrorism insurance. Although industry surveys are limited in their scope and not appropriate for marketwide projections, the surveys are consistent with each other in finding low "take-up" rates, the percentage of policyholders buying terrorism insurance, ranging from 10 to 30 percent. According to one industry survey, the highest take-up rates have occurred in the Northeast, where premiums were generally higher than the rest of the country.

The combination of low take-up rates and high concentration of purchases in an area thought to be most at risk raises concerns that, depending on its location, a terrorist event could have additional negative effects.

- If a terrorist event took place in a location not thought to be a terrorist "target," where most businesses had chosen not to purchase terrorism insurance, then businesses would receive little funding from insurance claims for business recovery efforts, with consequent negative effects on owners, employers, suppliers, and customers.
- Alternatively, if the terrorist event took place in a location deemed to be a "target," where most businesses had purchased terrorism insurance, then adverse selection could result in significant financial

[8]According to industry experts, the insurers that provided "free" terrorism insurance likely did so for policies already in place at the time TRIA was enacted and may have deferred operational changes and difficult pricing decisions because they lacked the resources to do so.

[9]Howard Kunreuther, Erwann Michel-Kerjan, and Beverly Porter, ***Assessing, Managing and Financing Extreme Events: Dealing with Terrorism*** (National Bureau of Economic Research: December 2003), 13.

problems for insurers. A small customer base of geographically concentrated, high-risk policyholders could leave insurers unable to cover potential losses, facing possible insolvency. If, however, a higher percentage of business owners had chosen to buy the coverage, the increased number of policyholders would have reduced the chance that losses in any one geographic location would create a significant financial problem for an insurer.[10]

Tighter Exclusions Leave Policyholders Exposed to Significant Perils

Since September 11, 2001, the insurance industry has moved to tighten long-standing exclusions from coverage for losses resulting from NBC attacks and radiation contamination. As a result of these exclusions and the actions of a growing number of state legislatures to exclude losses from fire following a terrorist attack, even those policyholders who choose to buy terrorism insurance may be exposed to potentially significant losses. Although NBC coverage was generally not available before September 11, after that event insurers and reinsurers recognized the enormity of potential losses from terrorist events and introduced new practices and tightened policy language to further limit as much of their loss exposures as possible. (We discuss some of these practices and exclusions in more detail in the next section.) State regulators and legislatures have approved these exclusions, allowing insurers to restrict the terms and conditions of coverage for these perils. Moreover, because TRIA's "make available" requirements state that terms for terrorism coverage be similar to those offered for other types of policies, insurers may choose to exclude the perils from terrorism coverage just as they have in other types of coverage. According to Treasury officials, TRIA does not preclude Treasury from providing reimbursement for NBC events, if insurers offered this coverage. However, policyholder losses from perils excluded from coverage, such as NBCs, would not be "insured losses" as defined by TRIA and would not be covered even in the event of a certified terrorist attack.

In an increasing number of states, policyholders may not be able to recover losses from fire following a terrorist event if the coverage in those states is not purchased as part of the offered terrorism coverage. We have previously reported that approximately 30 states had laws requiring coverage for "fire-following" an event—known as the standard fire policy

[10] Casualty Actuarial Society, *Foundations of Casualty Actuarial Science*, 4th ed. (United Book Press, Inc.: 2001), 51, 86.

(SFP)—irrespective of the fire's cause. Therefore, in SFP states fire following a terrorist event is covered whether there is insurance coverage for terrorism or not. After September 11, some legislatures in SFP states amended their laws to allow the exclusion of fire following a terrorist event from coverage. As of March 1, 2004, 7 of the 30 SFP states had amended their laws to allow for the exclusion of acts of terrorism from statutory coverage requirements.[11] However as discussed previously, the "make available" provision requires coverage terms offered for terrorist events to be similar to coverage for other events. Treasury officials explained that in all non-SFP states, and the seven states with modified SFPs, insurers must include in their offer of terrorism insurance coverage for fire following a certified terrorist event because coverage for fire is part of the property coverage for all other risks. Thus, policyholders who have accepted the offer would be covered for fire following a terrorist event, even though their state allows exclusion of the coverage. However, policyholders who have rejected their offer of coverage for terrorism insurance would not be covered for fire following a terrorist event. According to insurance experts, losses from fire damage can be a relatively large proportion of the total property loss. As a result, excluding terrorist events from SFP requirements could result in potentially large losses that cannot be recovered if the policyholder did not purchase terrorism coverage. For example, following the 1994 Northridge earthquake in California, total insured losses for the earthquake were $15 billion—$12.5 billion of which were for fire damage. According to an insurance expert, policyholders were able to recover losses from fire damage because California is an SFP state, even though most policies had excluded coverage for earthquakes.

Reinsurers Have Cautiously Returned to the Market, but Many Insurers Have Not Bought Reinsurance

Under TRIA, reinsurers are offering a limited amount of coverage for terrorist events for insurers' remaining exposures, but insurers have not been buying much of this reinsurance. According to insurance industry sources, TRIA's ceiling on potential losses has enabled reinsurers to return cautiously to the market. That is, reinsurers generally are not offering coverage for terrorism risk beyond the limits of the insurer deductibles and the 10 percent share that insurers would pay under TRIA (see app. I). In spite of reinsurers' willingness to offer this coverage, company representatives have said that many insurers have not purchased

[11] According to the National Association of Mutual Insurance Companies, Louisiana, Michigan, Minnesota, Nebraska, New Hampshire, Oklahoma, and Virginia have amended their standard fire policies to allow for exclusion of terrorism from statutory fire coverage. State legislators in Massachusetts have introduced a similar bill.

reinsurance. Insurance experts suggested that the low demand for the reinsurance might reflect, in part, commercial policyholders' generally low take-up rates for terrorism insurance. Moreover, insurance experts also have suggested that insurers may believe that the price of reinsurance is too high relative to the premiums they are earning from policyholders for terrorism insurance.

The relatively high prices charged for the limited amounts of terrorism reinsurance available are probably the result of interrelated factors. First, even before September 11 both insurance and reinsurance markets were beginning to harden; that is, prices were beginning to increase after several years of lower prices. Reinsurance losses resulting from September 11 also depressed reinsurance capacity and accelerated the rise in prices.[12] The resulting hard market for property-casualty insurance affected the price of most lines of insurance and reinsurance. A notable example has been the market for medical malpractice insurance.[13] The hard market is only now showing signs of coming to an end, with a resulting stabilization of prices for most lines of insurance. In addition to the effects of the hard market, reinsurer awareness of the adverse selection that may be occurring in the commercial insurance market could be another factor contributing to higher reinsurance prices. Adverse selection usually represents a larger-than-expected exposure to loss. Reinsurers are likely to react by increasing prices for the terrorism coverage that they do sell.

In spite of the reentry of reinsurers into the terrorism market, insurance experts said that without TRIA caps on potential losses, both insurers and reinsurers likely still would be unwilling to sell terrorism coverage because they have not found a reliable way to price their exposure to terrorist losses. According to industry representatives, neither insurers nor reinsurers can estimate potential losses from terrorism or determine prices for terrorism insurance without a pricing model that can estimate both the frequency and the severity of terrorist events. Reinsurance experts said that current models of risks for terrorist events do not have enough historical data to dependably estimate the frequency or severity of terrorist events, and therefore cannot be relied upon for pricing terrorism insurance. According to the experts, the models can predict a likely range

[12]Capacity is the amount of reinsurance or insurance that is available for a defined risk.

[13]U.S. General Accounting Office, ***Medical Malpractice Insurance: Multiple Factors Have Contributed to Increased Premium Rates***, GAO-03-702 (Washington, D.C.: June 27, 2003).

of insured losses resulting from the damage if specific event parameters such as type and size of weapon and location are specified. However, the models are unable to predict the probability of such an attack.

Even as they are charging high prices, reinsurers are covering less. In response to the losses of September 11, industry sources have said that reinsurers have changed some practices to limit their exposures to acts of terrorism. For example, reinsurers have begun monitoring their exposures by geographic area, requiring more detailed information from insurers, introducing annual aggregate and event limits, excluding large insurable values, and requiring stricter measures to safeguard assets and lives where risks are high.[34] And as discussed previously, almost immediately after September 11 reinsurers began broadening NBC exclusions beyond scenarios involving industrial accidents, to include events such as nuclear plant accidents and chemical spills and encompass intentional destruction from terrorists. For example, post-September 11 exclusions for nuclear risks include losses from radioactive contamination to property and radiation sickness from dirty bombs.

As of March 1, 2004, industry sources indicated that there has been little development or movement among insurers or reinsurers toward developing a private-sector mechanism that could provide capacity, without government involvement, to absorb losses from terrorist events. Industry officials have said that their level of willingness to participate more fully in the terrorism insurance market in the future will be determined, in part, by whether any more events occur. Industry sources could not predict if reinsurers would return to the terrorism insurance market after TRIA expires, even after several years and in the absence of further major terrorist attacks in the United States. They explained that reinsurers are still recovering from the enormous losses of September 11 and still cannot price terrorism coverage. In the long term and without another major terrorist attack, insurance and reinsurance companies might eventually return. However, should another major terrorist attack take place, reinsurers told us that they would not return to this market—with or without TRIA.

[34]Christian Brauner and Georges Galey, "Terrorism Risks in Property Insurance and Their Insurability after 11 September 2001," (Swiss Reinsurance Company: 2003), 25.

Conclusions

Congress had two major objectives in establishing TRIA. The first was to ensure that business activity did not suffer from the lack of insurance by requiring insurers to continue to provide protection from the financial consequences of another terrorist attack. Since TRIA was enacted in November 2002, terrorism insurance generally has been widely available even for development projects in high-risk areas of the country, in large part because of TRIA's "make available" requirement. Although most businesses are not buying coverage, there is little evidence that commercial development has suffered to a great extent—even in lower-risk areas of the county, where purchases of coverage may be lowest. Further, although quantifiable evidence is lacking on whether the availability of terrorism coverage under TRIA has contributed to the economy, the current revival of economic activity suggests that the decision of most commercial policyholders to decline terrorism coverage has not resulted in widespread, negative economic effects. As a result, the first objective of TRIA appears largely to have been achieved.

Congress's second objective was to give the insurance industry a transitional period during which it could begin pricing terrorism risks and developing ways to provide such insurance after TRIA expires. The insurance industry has not yet achieved this goal. We observed after September 11 the crucial importance of reinsurers for the survival of the terrorism insurance market and reported that reinsurers' inability to price terrorism risks was a major factor in their departure from the market. Additionally, most industry experts are tentative about predictions of the level of reinsurer and insurer participation in the terrorism insurance market after TRIA expires. Unfortunately, insurers and reinsurers still have not found a reliable method for pricing terrorism insurance, and although TRIA has provided reinsurers the opportunity to reenter the market to a limited extent, industry participants have not developed a mechanism to replace TRIA. As a result, reinsurer and consequently, insurer, participation in the terrorism insurance market likely will decline significantly after TRIA expires.

Not only has no private-sector mechanism emerged for supplying terrorism insurance after TRIA expires, but to date there also has been little discussion of possible alternatives for ensuring the availability and affordability of terrorism coverage after TRIA expires. Congress may benefit from an informed assessment of possible alternatives—including both wholly private alternatives and alternatives that could involve some government participation or action. Such an assessment could be a part of Treasury's TRIA-mandated study to "assess…the likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the Program."

Recommendation for Executive Action

As part of the response to the TRIA-mandated study that requires Treasury to assess the effectiveness of TRIA and evaluate the capacity of the industry to offer terrorism insurance after TRIA expires, we recommend that the Secretary of the Treasury, after consulting with the insurance industry and other interested parties, identify for Congress an array of alternatives that may exist for expanding the availability and affordability of terrorism insurance after TRIA expires. These alternatives could assist Congress during its deliberations on how best to ensure the availability and affordability of terrorism insurance after December 2005.

Mr. Chairman, this concludes my prepared statement, and I would be pleased to respond to any questions that you or other members of the Committee may have.

Contacts and Acknowledgments

For further information regarding this testimony please contact Richard J. Hillman, Director, or Lawrence D. Cluff, Assistant Director, Financial Markets and Community Investment, (202) 512-8678. Individuals making key contributions to this testimony include Rachel DeMarcus, Barry Kirby, Tarek Mahmassani, Angela Pun, and Barbara Roesmann.

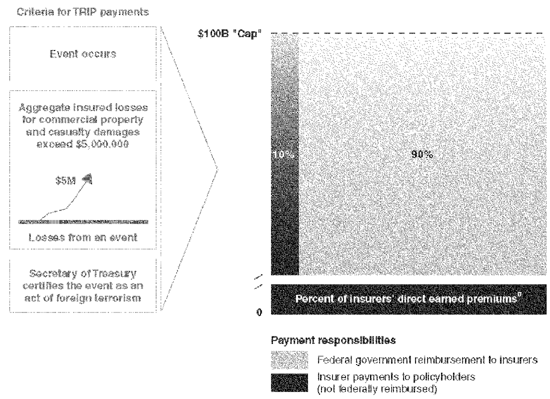
Appendix I: TRIA Background

Under TRIA, Treasury is responsible for reimbursing insurers for a portion of terrorism losses under certain conditions. Payments are triggered when (1) the Secretary of the Treasury certifies that terrorists acting on behalf of foreign interests have carried out an act of terrorism and (2) aggregate insured losses for commercial property and casualty damages exceed $5,000,000 for a single event.[1] TRIA specifies that an insurer is responsible (that is, will not be reimbursed) for the first dollars of its insured losses—its deductible amount. TRIA sets the deductible amount for each insurer equal to a percentage of its direct earned premiums for the previous year.[2] Beyond the deductible, insurers also are responsible for paying a percentage of insured losses. Specifically, TRIA structures pay-out provisions so that the federal government shares the payment of insured losses with insurers at a 9:1 ratio—the federal government pays 90 percent of insured losses and insurers pay 10 percent—until aggregate insured losses from all insurers reach $100 billion in a calendar year (see fig. 1). Thus, under TRIA's formula for sharing losses, insurers are reimbursed for portions of the claims they have paid to policyholders. Furthermore, TRIA then releases insurers who have paid their deductibles from any further liability for losses that exceed aggregate insured losses of $100 billion in any one year. Congress is charged with determining how losses in excess of $100 billion will be paid.

[1] Aggregate insured losses are the sum of insured property and casualty losses from all commercial policyholders that result from a certified act of terrorism.

[2] Section 102(4) of TRIA defines direct earned premiums as "a direct earned premium for property and casualty insurance issued by any insurer for insurance against losses …" Treasury provided further clarification that direct earned premiums are "earned as reported to the NAIC in the Annual Statement in column 2 of Exhibit of Premiums and Losses (commonly known as Statutory Page 14)" and cover all risks, not only for risks from terrorism. The percentage of the direct earned premium allowed as an insurer deductible varies over the program years: 7 percent in 2003, 10 percent in 2004, and 15 percent in 2005.

Figure 1: Prerequisites for and Limits of Coverage Under TRIA



Source: GAO analysis of Terrorism Risk Insurance Act of 2002

[a]The percentage of direct earned premiums increases each year: 7 percent in 2003, 10 percent in 2004, and 15 percent in 2005.

TRIA also contains provisions and a formula requiring Treasury to recoup part of the federal share if the aggregate sum of all insurers' deductibles and 10 percent share is less than the amount prescribed in the act—the "insurance marketplace aggregate retention amount." TRIA also gives the Secretary of the Treasury discretion to recoup more of the federal payment if deemed appropriate.[5] Commercial property-casualty policyholders would pay for the recoupment through a surcharge on

[5]According to Treasury officials, the formula for the mandatory portion of the recoupment is intended to ensure that the insurance industry is financially responsible for a prescribed level of the first dollars of losses. The prescribed loss levels are as follows: $10 billion in 2003, $12.5 billion in 2004, and $15 billion in 2005. Therefore, if the sum of insurers' aggregate payments for deductibles and the 10 percent share—the amounts paid by industry—is less than the level prescribed for that year, then a recoupment would be required to collect the difference. On the other hand, if the amounts paid by industry exceed the prescribed level, then a recoupment would not be needed.

premiums for all the property-casualty policies in force after Treasury established the surcharge amount; the insurers would collect the surcharge. TRIA limits the surcharge to a maximum of 3 percent of annual premiums, to be assessed for as many years as necessary to recoup the mandatory amount. TRIA also gives the Secretary of the Treasury discretion to reduce the annual surcharge in consideration of various factors such as the economic impact on urban centers. However, if Treasury makes such adjustments, it has to extend the surcharges for additional years to collect the remainder of the recoupment.

Treasury is funding the Terrorism Risk Insurance Program (TRIP) office —through which it administers TRIA provisions and would pay claims— with "no-year money" under a TRIA provision that gives Treasury authority to utilize funds necessary to set up and run the program.[4] The TRIP office had a budget of $8.97 million for fiscal year 2003 (of which TRIP spent $4 million), $9 million for fiscal year 2004, and a projected budget of $10.56 million for fiscal year 2005 a total of $28.53 million over 3 years. The funding levels incorporate the estimated costs of running a claims-processing operation in the aftermath of a terrorist event: $5 million in fiscal years 2003 and 2004 and $6.5 million in fiscal year 2005, representing about 55–60 percent of the budget for each fiscal year. If no certified terrorist event occurs, the claims-processing function would be maintained at a standby level, reducing the projected costs to $1.2 million annually, or about 23 percent of the office's budget in each fiscal year. Any funds ultimately used to pay the federal share after a certified terrorist event would be in addition to these budgeted amounts.

[4]"No-year money" is budget authority that remains available for obligation until expended, usually until the objectives for which the authority was made available are attained.

PREPARED STATEMENT OF J. ROBERT HUNTER

DIRECTOR OF INSURANCE, CONSUMER FEDERATION OF AMERICA

MAY 18, 2004

Good morning, Mr. Chairman and Members of the Committee. I am J. Robert Hunter, Director of Insurance for the Consumer Federation of America. CFA is a nonprofit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy, and education. I am a former Federal Insurance Administrator under Presidents Ford and Carter and have also served as Texas Insurance Commissioner.

I have drawn many of my conclusions regarding the Terrorism Risk Insurance Act of 2002 (TRIA) based on my experience administering a similar Federal reinsurance plan, the Riot Reinsurance Program. This program kept insurance in the inner cities in the early 1970's, when riots threatened the withdrawal of property insurance from the Nation's inner cities. We charged insurers actuarially sound premiums for the reinsurance and, when the program was terminated, taxpayers actually realized a profit from the transaction.

The Nation's terrorism insurance law is not necessary to ensure the availability of affordable terrorism coverage for most areas of the country and should be allowed to expire. CFA reached this conclusion after undertaking a major study of the workings of TRIA and of current market conditions for property/casualty insurance. A copy of the report is attached to this testimony.

We found that insurance experts have set terrorism insurance rates for the third year of the program, 2005, at quite low levels in most of the country and that, according to insurance risk models, private insurers will be completely responsible for all terrorism insurance losses in all but nine large cities by 2005.

The study clearly documents that the insurance industry is more than ready to stand on its own two feet and that taxpayer back up should end. The ability of the industry to insure against terrorism is enormous and growing, profits are quite substantial, and the financial condition of insurers overall is rock solid. Profits leapt ten-fold in the last year, and surplus (retained earnings) skyrocketed by $65 billion!

However, if Congress decides to keep some form of back up, it should only target the few areas of the country where getting affordable terrorism coverage might be a problem. Congress should also require insurers to broaden the amount of coverage they offer, pay for the reinsurance that taxpayers provide, only back up truly large terrorism events, and increase incentives for the further development of a private terror insurance market.

Background on TRIA and Major Findings

TRIA created a 3-year program in which the Federal Government covers 90 percent of all terrorism-related insurance losses (up to $100 billion a year) after individual insurance companies pay an initial deductible. Insurers, who are required to offer terrorism coverage, must repay very little or no assistance. The Act ends on December 31, 2005, unless renewed by Congress.

The CFA study, *The Terrorism Risk Insurance Act: Should It Be Renewed?,* assesses current prices for terrorism insurance and the increasing ability of the property/casualty insurance industry to cover terrorism losses without taxpayer back up.[1] CFA based its analysis in large part on a determination by the Insurance Services Office (ISO) that the risk of terrorism in the United States varies geographically:

- Areas with a high risk of attack are: New York City; San Francisco County; Washington, DC; and Cook County, Illinois (Chicago);
- Areas with a moderate risk of attack are: Suffolk County, Massachusetts (Boston); King County, Washington (Seattle); Los Angeles County; Harris County, Texas (Houston); and Philadelphia County.
- The remainder of the country is at a low risk of attack.

The report has several major conclusions:

1. Terrorism insurance rates are relatively low in most areas of the country and will continue to be so when TRIA expires, as industry experts have concluded that most of the country has no significant terrorism risk under TRIA. Based on data collected by ISO, CFA estimates that terrorism insurance rates will be extremely low in these areas when TRIA expires. For example, in the lowest risk areas of the country, CFA calculates that a $10 million building with $5 million in contents would cost only $300 to insure against terrorism once the law expires, the

[1] The report can be found at: *http://www.consumerfed.org/terrorism_insurance_report.pdf.*

same cost as in the final year of TRIA. In moderate risk areas, this cost would only be $6,526 when TRIA expires, $326 more than during the last year of the program.

2. The private sector will cover all terrorism losses in all but nine large cities by 2005, before TRIA expires. Even in those nine areas, insurers will be covering the vast majority of the risk. This is according to the calculations of the ISO model regarding the risk of terrorist attacks, including attacks using weapons of mass destruction (WMD) and other catastrophic possibilities. This means that the insurance industry should have the capacity to cover all but perhaps the most risky areas of the country without help from taxpayers. In the five moderate-risk cities mentioned above, private insurers will be covering 95 percent of the risk by 2005. In the four high-risk areas of the country, insurers will be covering 70 percent of the risk.

3. Commercial insurance buyers in most of the Nation are reluctant to buy taxpayer-backed insurance coverage. This is because of the perception that terrorism will not impact them and that, even at very affordable rates, the price is too high. According to a recent survey by the Council of Insurance Agents and Brokers, half of the commercial brokers they questioned said that only 20 percent of their clients are actually buying federally backed terrorism insurance.

4. Industry experts have projected that terrorism insurance losses will be relatively modest. ISO has projected terrorism insured losses annually to be $5.75 billion before tax considerations. To put this projection into perspective, industry losses on September 11 have recently been lowered to $30 to $35 billion before tax considerations (about $20 billion after taxes). ISO thus projects a September 11 level of loss just about every 6 years.

5. Insurers are in an excellent financial position to cover all terrorism losses after TRIA expires. The profits of insurers selling TRIA-backed terror coverage are excellent, as is the financial solidity of the industry. The return on equity for four of the five top stock insurance groups exceeded a very substantial 16 percent in 2003. These profits are expected to remain good for some years to come, as the industry continues to benefit from a "hard market" cycle that has kept premiums and profits high. Overall, the property/casualty insurance industry added 22 percent to policyholder surplus in 2003 (a whopping $65 billion) according to A.M. Best and Co. Meanwhile, financial soundness, which is measured by the amount of surplus the industry has compared to the coverage it has extended (net written premium), is very strong.

Public Policy Recommendations

Based on the relatively low risk of terrorism attacks and low rates in much of the country, as well as strong industry profitability and financial soundness and the growing capacity of insurers to offer terrorism coverage, CFA found no compelling reason to extend TRIA at the end of 2005. The only possible reason Congress might want to consider some form of limited taxpayer back up after TRIA expires would be to assist the nine cities at moderate or high risk of terror attacks.

However, if Congress considers such a plan, it should:

- **Target only the cities where the risk of attack is moderate or high.** In fact, it is highly unlikely that the five cities at moderate risk of attack will need assistance, as 95 percent of all potential terrorism losses will be covered by the insurance industry by the end of 2005.
- **Increase the deductibles that insurers must pay for losses in these few cities.** CFA suggests an industry-wide deductible of $50 billion after tax considerations—a pretax deductible of $77 billion—for the first year of a new program, increasing by $10 billion a year thereafter.
- **Increase the share of losses that insurers must pay above the deductible amount** from 10 percent to 15 percent, increasing by 5 percent a year.
- **Only provide taxpayer back up for truly exceptional terrorist events,** such as attacks with WMD, and
- **Ensure that taxpayers pay no costs for backing up terrorism losses.** The Treasury Department should require that insurers pay premiums for the coverage that taxpayers are providing that are actuarially sound, if a not a little higher than estimated taxpayer costs. Requiring insurers to pay rates that are slightly higher than estimated will encourage private insurance mechanisms to quickly compete by offering lower rates.

I hope you will keep in mind these findings, which are based on a market assessment being used by the insurance industry itself, when considering the future of TRIA. The evidence strongly suggests that it is no longer necessary for taxpayers to provide free reinsurance to property-casualty insurers.

Thank you. I will be happy to respond to your questions at the appropriate time.

Consumer Federation of America

THE TERRORISM RISK INSURANCE ACT: SHOULD IT BE RENEWED?

A Report by the Consumer Federation of America

April 19, 2004

J. Robert Hunter
Director of Insurance
Consumer Federation of America
1424 16th Street, NW Suite 604
202-387-6121
www.consumerfed.org

BACKGROUND

In November of 2002, President Bush signed into law the Terrorism Risk Insurance Act of 2002. TRIA set up a program of federal reinsurance with no premium charged to the insurers. It mandated that the insurers write terrorism coverage, which would then be backed by the federal reinsurance program.

If and when a terrorism event occurs, the Secretary of the Treasury must certify that it qualifies as a reimbursable loss under TRIA, with at least $5 million in aggregate losses. Someone acting on behalf of a foreign interest must also commit the attack. If an incident meets these criteria taxpayers pay for insurance industry losses in accordance with a schedule that varies over time.

In 2003, insurers were responsible for losses below a deductible of 7 percent of insurers' direct earned premium (DEP) for eligible commercial lines in the 2002 calendar year. In 2004, 10 percent of the 2003 DEP is the deductible. In 2005, 15 percent of the 2004 DEP is the deductible[1].

Above the deductible amount, the federal "backstop" is 90 percent of a company's insured terrorism losses, capped at an overall industry level of $100 billion.

If an event triggers federal involvement, insurers will be required to pay back a very small layer of taxpayer assistance, which could be passed on to insurance consumers in the form of a surcharge, but it is not a significant amount in major terrorism events.[2]

This study assumes that TRIA will be extended through 2005. The question that will be considered is whether TRIA should be extended beyond 2005 and, if so, what should be the requirements of any extension.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

After evaluating the availability and pricing of terrorism insurance in the current market, it is clear that TRIA is no longer needed. Industry experts have concluded that most of the country has no significant terrorism risk under TRIA. The private sector will be covering the entire risk by 2005 in all but nine large cities. The only question is whether these nine cities, identified by industry experts as the most likely target areas of terrorists, need any taxpayer support beyond

---

[1] If the program is extended to 2005 (a decision that the Secretary of the Treasury must make by September 2004 under the provisions of TRIA).

[2] TRIA does not require any payback if losses exceed $10 billion in the first year of the program, $12.5 billion in the second, and $15 billion in year three. Even when payback is required, it is miniscule: insurers would only pay back the difference between the total amount of retentions paid by individual insurers and the caps stated above.

2005. As a result, CFA believes that there is no need to extend TRIA when it expires at the end of 2005.

However, if Congress considers any such back up, it should:

- Target only the nine cities where the risk is high;
- Encourage private insurance mechanisms to quickly assume the risk;
- Only back up truly exceptional events, such as attacks with weapons of mass destruction (WMD); and
- Result in no cost to taxpayers, as the Treasury Department should require that actuarial rates, if not greater-than-actuarial-rates, be charged for such coverage.

THE KEY QUESTION FOR CONGRESS

The central focus of this study, and the primary question before Congress in considering any extension of TRIA beyond 2005, is what is the best estimate of the risk of terrorism available in the marketplace and can the private sector handle such risk absent taxpayer back-up.

The Treasury official charged with administering the TRIA program, Assistant Secretary Wayne Abernathy, has indicated that it is his initial assessment that the TRIA program should not be extended beyond 2005.

THE ISO MODEL

CFA has reviewed filings made with insurance departments establishing rates for terrorism coverage under TRIA. The most sophisticated analysis in these filings is that of the Insurance Services Office (ISO). Moreover, major segments of the insurance markets rely on the ISO approach to price the terrorism insurance they must offer under TRIA.

ISO is a ratemaking/ advisory organization licensed in almost all of the states. Many insurers follow ISO "loss cost" filings and adopt these filings, or major parts of these filings, for their own rating of risks. This is particularly true for terrorism insurance.

ISO has, for many years, operated on behalf of many companies that affiliate with it in a number of ways, from purchasing its services to membership in the ISO organization. ISO functions by developing what are known as "loss costs." Loss costs are that part of the rate that covers the expected claims and adjustment expenses, but not underwriting expenses and profit. For most lines of insurance, ISO files the loss costs with state insurance commissioners. These estimates are either formally approved or deemed allowable by the states without approval. TRIA overrode such state approval, but states can and have subsequently reviewed the rates, asked questions and, on occasion, have disapproved insurer filings. Once the loss costs are effective in a state, insurers add on their own expense and profit factors to the loss costs, or some derivative of them, as the basis for the rates they then charge to businesses.

ISO is known as a conservative rate-maker (i.e., pricing on the high side to protect all insurers who adopt its pricing recommendations.)

ISO owns a modeling company, AIR, which has developed models to price natural catastrophes such as hurricanes and earthquakes. AIR was tasked by ISO with developing a terrorism model to estimate terrorism insurance expected losses.

The AIR terrorism model estimates losses to property/casualty insurers from future terrorism attacks in America. It considers all sorts of terrorism: domestic and international, conventional and WMD. In estimating the loss costs for TRIA, AIR focused on the TRIA covered commercial lines of property/casualty insurance.

AIR modeled both the frequency and the severity of attack, employing the advice of terrorism experts[3] and utilizing the Delphi Method to combine the opinions of the experts with historical information. The Delphi Method was employed because historical data alone on terrorist activities was thought to be too sparse to be useful without additional analytic information. This situation is similar to the need that existed after Hurricane Andrew to come up with new methods for predicting hurricane risk. Up till then, the insurers thought they could base hurricane insurance rates solely on recent history. Andrew taught insurers that they needed to examine thousands of computer-generated years of experience beyond the historical data to obtain an accurate projection of future losses.

The AIR model developed information on over 300,000 targets (such as airports, churches, etc.). The experts estimated which targets were high-risk and which were not. They developed detailed information on each terrorist group, including their historic attack frequency and weapons used. Conventional weapons, plane crashes, bombs and WMD (chemical, biological, radiological and nuclear) were all considered in the severity calculations.

The models were applied to the structures (i.e., the actual insured buildings for the industry) in the database, estimating damage from each type of weapon to the exposed properties.

Based upon the model, ISO concluded that the risk of terrorism varied between geographical locations. They split the nation into three tiers:

<u>Tier 1 -- High Hazard</u>

New York City (all boroughs)
San Francisco County, CA
Washington, D.C.
Cook County IL (Chicago)

<u>Tier 2 – Moderate Hazard</u>

Suffolk County, MA (Boston)
King County, WA (Seattle)
Los Angeles County, CA

[3] Counter-terrorism experts with experience at the top levels of government were employed, including those from CIA, FBI, DOD, DOE and other agencies.

Harris County, TX (Houston)
Philadelphia County, PA

Tier 3 – Low Hazard

Remainder ~~of U.S.A.~~

AIR calculated loss costs based upon these tiers for most lines of insurance. In General Liability, the same loss cost was used across the nation; no tiers were employed.

ISO adjusted the AIR calculations for several actuarial considerations, including the TRIA backstop effect (lowering the loss costs when the Act has the taxpayer bearing the most risk and raising it when the taxpayer liability is lower.) In the final analytical run, AIR did not evaluate the WMD part of the loss cost projection, so ISO significantly increased the loss costs to reflect this risk as a separate step in the process. For instance, based upon the expert input, ISO doubled the loss costs from conventional weapons for property coverages.

ISO estimated the percentage of risk retained by insurance companies as part of this calculation. As the deductibles rise during the three years of the Act, the insurer retention also rises. ISO calculates the retention of insurers under TRIA to be:

Tier	TRIA Year 1	TRIA Year 2	TRIA Year 3
1	40%	55%	70%
2	75%	85%	95%
3	90%	95%	100%

This means that, by year 3, 2005, the private sector is fully covering the risk in all but the nine cities of Tiers 1 and 2.

The model and ISO adjustments projected terrorism insured losses annually to be $5.75 billion before tax considerations. To put this projection into perspective, the 9/11 loss was $40 billion before tax considerations. ISO thus projects a 9/11 level of loss every 6.96 years.

Over time, ISO anticipates that terrorism insured losses will be 50 percent in property losses, 10 percent in general liability losses and 40 percent in other losses (including workers' compensation, aviation, inland marine, etc.)

ISO RESULTS

Since half of the ISO projected losses are property insurance, our analysis closely examines that line of insurance.

The ISO loss costs per $100 of terrorism coverage purchased by a business for property insurance is as follows:

LOSS COSTS FOR TERRORISM UNDER TRIA
BUSINESS PROPERTY INSURANCE

	PROGRAM YEAR ONE		PROGRAM YEAR TWO		PROGRAM YEAR THREE	
TIER	BUILDING	CONTENTS	BUILDING	CONTENTS	BUILDING	CONTENTS
1	0.108	0.078	0.145	0.106	0.183	0.134
2	0.018	0.012	0.021	0.014	0.023	0.016
3	0.001	0.001	0.001	0.001	0.001	0.001

What does this loss cost table mean in terms of what an insured building's insurance premium might be in year three of the program?

The loss cost is the risk portion of the ultimate price a policyholder might pay. The insurance company would add two factors to account for: (1) the expenses of underwriting and (2) a profit allowance. This analysis estimates that 50 percent of the premium is being used for overhead expenses and profit and 50 percent to pay loss costs. [4] In other words, loss costs are doubled to estimate the total premium.

The estimate further assumes that the value of the structure being insured is $10 million and the contents in that building are worth $5 million.

In the third year of TRIA (2005), the rate for tier 1 would be 36.6¢ per $100 for the building[5]. Multiplying that by $10 million produces a premium for the building of $36,600. For contents, the rate would be 26.8¢ per $100[6]. The premium for $5 million in contents would be $13,400.00. The total premium for that property, including contents, would be $50,000.

If the TRIA backstop were removed, the $50,000 would rise to $71,428.57, an increase of $21,428.57. This is calculated by dividing the $50,000 by the insurance company retention for year 3 in tier 1 of 70%.

In the third year (2005), the rate for tier 2 would be 4.6¢ per $100 for the building[7]. Multiplying that by $10 million produces a premium for the building of $4,600. For contents, the rate would be 3.2¢ per $100[8]. The premium for $5 million in contents would be $1,600. The total premium for that property, including contents, would be $6,200.

If the TRIA backstop were removed, the $6,200 would rise to $6,526.32, an increase of $326.32. This is calculated by dividing the $6,200 by the insurance company retention for year 3 in tier 2 of 95%.

[4] Based on the industry-wide average expense for 2002 for commercial property predominating insurers of 28 percent of premium, plus a very generous profit to premium ratio of 22 percent.
[5] 18.3¢ per $100 times 2.
[6] 13.4¢ per $100 times 2.
[7] 2.3¢ per $100 times 2.
[8] 1.6¢ per $100 times 2.

In the third year (2005), the rate for tier 3 would be 0.2¢ per $100 for building[9]. Multiplying that by $10 million produces a premium for the building of $200. For contents, the rate would be 0.2¢ per $100[10]. The premium for $5 million in contents would be $100. The total premium for that property, including contents, would be $300.

If the TRIA backstop were removed, the $300 would not rise since the insurer retention in year 3 for tier 3 is 100% of the risk.

Commercial property is half of the risk of terrorism, according to ISO's model. Other lines have even lower prices.

Commercial auto liability uses a loading of a percentage of premiums of 1/10th of one percent to calculate the terrorism premium and for physical damage the load is 8/10th of one percent.

Commercial general liability (premises operations and products) uses business type classes to rate the coverage. Above average classes for premises operations liability insurance include such businesses as oil refineries and dams. Airline and chemical manufacturers are examples of the higher risk businesses for products liability insurance, according to ISO. Third year premium factors for this line of terrorism insurance are as follows:

Tier	Above Average Classes	Below Average Classes
1	.198	.009
2	.083	.041
3	.017	.009

THE NCCI MODEL/NCCI RESULTS

NCCI is a ratemaking/ advisory organization licensed in almost all of the states. It focuses on workers' compensation insurance. Many insurers follow NCCI loss cost filings and adopt these filings, or major parts of these filings, for their own rating of risks.

NCCI has, for many years, operated on behalf of many companies that affiliate with it in many ways, from purchasing its services to becoming a member of the organization. Like ISO, NCCI functions by developing what are known as "loss costs."

NCCI is also known as a conservative rate-maker (i.e., pricing on the high side to protect all insurers who adopt its pricing recommendations.)

For terrorism insurance ratemaking, NCCI also used modeling. It selected the EQECAT firm for this purpose.

The NCCI has filed rates of 2¢ per $100 of payroll in most states. Higher rates were filed in some places, such as DC, where loss costs were filed at 7¢ per $100. According to NCCI, the

[9] 0.1¢ per $100 times 2.
[10] 0.1¢ per $100 times 2.

estimated premium impact from the TRIA risk nationally is 1.5%, varying by state. Some examples are DC at 12.5%, Virginia at 3.8%, Arizona at 2.0% and Louisiana at 0.8%.

DESPITE LOW RATES FOR MOST AREAS, THERE ARE FEW BUYERS OF TRIA BACKED TERROR COVERAGE

According to a survey by the Council of Insurance Agents and Brokers, (CIAB) "Half of the commercial brokers responding to the survey said fewer than 20 percent of their clients are actually buying the federally backed terrorism coverage. They attributed the low interest primarily to the high cost of coverage and to their clients' belief that they are not likely to be targets of terrorism."

Our analysis clearly reveals that costs are low in most of the country. Commercial insurance buyers in most of the nation are reluctant to buy TRIA backed coverage because of the perception that terrorism will not impact them and that, even at very affordable rates, the price is too high.

This finding of the CIAB survey supports our contention that ISO and NCCI price at the high end of the indications to make the rates attractive to even their most ineffective underwriting insurance affiliates. The risk is viewed as extremely remote in areas outside of the four target cities of ISO Tier 1 by both the experts that consulted with AIR/ISO and by the buyers of insurance.

CURRENT PROPERTY/CASUALTY INSURER PROFITABILITY AND FINANICAL SOUNDNESS

The profits of the insurers selling TRIA-backed terror coverage are excellent now, and are expected to remain good for some years to come, as the industry ends its hard market phase.

Overall, the property/casualty insurance industry added 22 percent to policyholder surplus in 2003 (a whopping $65 billion!) according to A.M. Best and Co.[11]

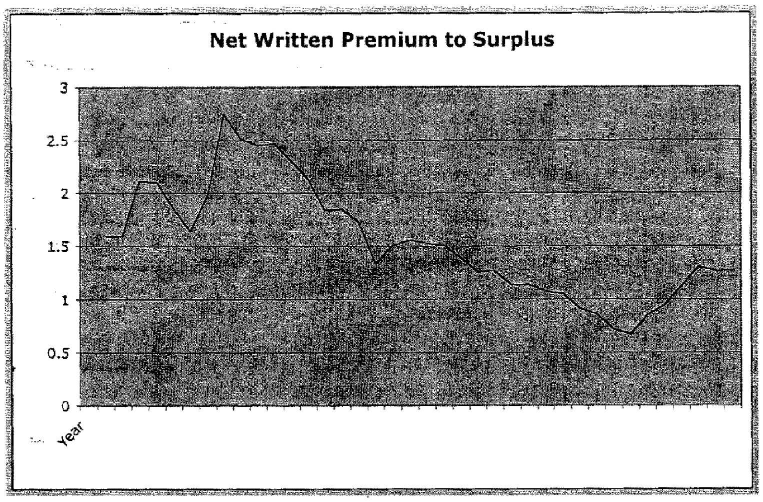
The top five stock insurance groups in the nation are Allstate, AIG, Zurich, Berkshire Hathaway and Travelers, with written premiums of $23.3 billion, $21.0 billion, $17.4 billion, $15.2 billion and $11.9 billion respectively. (State Farm, the nation's largest insurer at $42.7 billion, is a mutual insurer specializing in personal lines coverage.)

Consider the outstanding profits of these insurers in 2003:

Allstate	$2.3 billion (16.5% ROE)
AIG	$9.3 billion (17.2% ROE)
Zurich	$2.1 billion (12.5% ROE)
Berkshire Hathaway	$8.2 billion (16.2% ROE)
Travelers	$1.7 billion (17.4% ROE)

[11] Special Report of April 12, 2004, "Industry Reports Dramatically Improved 2003 Operating Results," A.M. Best & Co.

The most common test of the financial solidity of the property-casualty insurance industry is the ratio of net premiums written to surplus (retained earnings). Here is how that key ratio has performed over time:



As the chart reveals, the ratio has declined, generally, over time. During the recent soft market it rose from under 1 to 1 to about 1.3 to 1, still very safe by historical ratio standards. The recent increase in the ratio has now stabilized and, if past history of the years following a hard market is a guide, will start dropping again shortly. The historic safe level, known as the "Kenney Rule" for the financial writer Roger Kenney, is 2 to 1. Commissioners get particularly concerned if the ratio approaches 3 to 1.

The industry is doing very well and is fundamentally very sound. It can afford this terrorism risk.

The ISO estimates the industry-wide expected losses from terrorism are $5.75 billion per year. In 2002, AM Best reported premiums written for commercial lines of $184 billion and incurred losses of $127 billion. Surplus, calculated at the current 1.3 to 1 ratio of premiums to surplus, is about $142 billion. Related to premiums, the terrorism risk per year is about 3 percent. Related to losses, the terrorism expected losses are about 4.5 percent. Related to surplus, expected annual terrorism losses are about 4 percent.

These are manageable costs when the average terrorism loss projected by ISO is incurred. However, there is substantial variation around the average loss, since most years have no terrorist attacks but some years see significant damage from terrorist attacks. Some of the variation (particularly variations by carrier) can be controlled if the insurers set up voluntary pooling arrangements. To the extent that there are major losses in excess of, say, $50 billion after taxes,[12] federal taxpayer involvement might be helpful.

ANALYSIS

The best analysis of the terrorism risk CFA has seen is the ISO model. The results of the model show that the risk is relatively manageable for insurance companies, especially now that insurers are extremely profitable and their retained earnings/surpluses are high. For most areas of the country, terrorism risk premiums are very low, indicating a low assessment of risk by insurers. However, even at very affordable rates, business consumers are not buying the coverage because they view the risk as minimal to non-existent. According to the ISO model, the costs of terrorism events in Tier 3 areas of the nation (all areas excerpt for the nine large cities of Tiers 1 and 2) will be fully covered by the private market as of year three (i.e., 100 percent industry retained, zero percent taxpayer retained in 2005).

The only risks requiring consideration of taxpayer back up are in the nine cities of ISO Tiers 1 and 2 and particularly in the four Tier 1 cities.

Insurers might argue that without taxpayer support, they will not be able to offer affordable prices and will either not write the coverage or price it at much higher levels. Insurers also claimed that this would happen in early 2002, when the Senate did not pass the backstop legislation. But the threatened collapse of the market did not happen. Indeed, CFA studies of that period, when private reinsurance expired, showed that the insurance market was responding to all risks, even skyscrapers in New York City.[13]

Even without federal back up, terrorism insurance would be surprisingly affordable. As the above analysis shows, there should be no increase in pricing in most of the nation – except for nine cities – even if the backstop were eliminated. In Tier 2 areas, an owner of a $10 million building with $5 million in contents would see only a $326 increase.

In the four highest risk cities, an owner of a building valued at $10 million, with $5 million in contents, would see an increase of $21,429. These cost increases are very manageable unless a truly monumental terrorist attack occurs, perhaps using WMD. It is not the average expected costs that present a problem; it is the possibility, however remote, of a huge loss far exceeding the 9/11 level of loss.

There is, therefore, no justification for renewing TRIA in its current configuration. The private sector can and will respond to the withdrawal of TRIA with innovations (such as pooling, reinsurance, and securitization) to keep the market functioning well with no federal back up.

[12] The insurance industry handled 9-11 losses with little difficulty. They were $40 billion before tax consideration and $24 billion after.

[13] See, e.g., "How the Lack of Federal Back-Up for Terrorism Insurance Has Affected Insurers and Consumers: An Update," CFA, 1/23/02; "Testimony of J. Robert Hunter Before the Oversight and Investigations Subcommittee of the House Financial Services Committee on the Terrorism Insurance Market since September 11th," February 27, 2002.

IF A SUCCESSOR TO TRIA IS NEEDED, WHAT SHOULD IT LOOK LIKE?

If Congress feels that it needs to leave in place a terrorism insurance backstop, CFA offers these principles for adoption of any new program:

- It should minimize interference with the development of private insurance and reinsurance markets;
- It should limit taxpayer support to truly large events from the terrorist use of WMD, such as chemical, biological and nuclear weapons; and
- It should come at no overall cost to the taxpayer.

If Congress considers it necessary to adopt a plan, it should be structured in the following way:

First, there is certainly no need for a plan in Tier 3, that part of the nation outside of New York, DC, San Francisco, Chicago, Boston, Seattle, LA, Houston and Philadelphia.

Second, it is highly doubtful that any plan is needed in Tier 2 (Boston, LA, Seattle, Houston and Philadelphia), since 95 percent of the risk for these will be covered privately by the end of 2005 according to ISO, leaving only 5 percent to be paid for by taxpayers.

Third, the plan for the few remaining cities that might require back-up should order industry-wide deductibles of more than the 15 percent that is mandated in year 3 of the current program. We suggest an industry-wide deductible of $50 billion, after tax considerations (i.e., a pre-tax deductible of $76.9 billion[14]) for the first year of the renewed TRIA, increasing by $10 billion a year after that.

Fourth, the share of losses that insurers are required to pay above the deductible amount must be increased. TRIA currently requires insurers to pay for 10 percent of losses above the deductible amount the insurer retains. That is, if an insurer had a deductible of one million dollars and suffered a TRIA eligible loss of two million, TRIA would pay $900 thousand and the insurer would pay $100 thousand. If a new TRIA is put in place after 2005, this co-pay should be made higher for the industry, perhaps starting at 15% and increasing by 5% a year thereafter. The fact that insurer capacity to provide terrorism coverage has grown since 9-11 should be reflected in any new backstop that is put on the books.

Fifth, insurers should be charged a premium for the reinsurance provided by the government, in order to pay for the taxpayer exposure required under any extension of the Act. In our view, these charges should exceed the actuarial indications in order to allow private reinsurers to take steps to compete with the government program. CFA suggests charging insurers a terrorism premium of 125 percent of what is actuarially necessary in the first year, increasing by 25 percent each year thereafter (e.g., 150 percent in the second year of any extension to TRIA). The

[14] $50 billion adjusted by the corporate tax rate of 35 percent [$50 billion/(1 - 0.35)].

Federal Riot Reinsurance Program (under the Urban Property Protection Act of 1968) should be used as model in pricing terrorism coverage. This plan charged actuarial rates to back up the insurance industry in keeping riot coverage in place in the nation's inner cities following the riots of the late-1960s. Taxpayers made money on sales of riot reinsurance, while maintaining property insurance availability and affordability throughout the country. There is no reason why taxpayers should subsidize the wealthy property/casualty insurance industry in the provision of terrorism insurance.

In order for insurers to have time to develop voluntary pooling arrangements, for the reinsurance market to have time to develop pricing for the private backstop, and for states to consider necessary actions, CFA calls on the Treasury Department to make its proposals for the post-2005 period known quickly.

NECESSARY STATE ACTIONS

States should also be active in the period before TRIA expires on December 31, 2005. They should be prepared to allow reasonable rate increases to reflect the withdrawal of the taxpayer-provided free reinsurance under TRIA. They should take firm action to assure that rates do not go up more than necessary. It is clear that minimal increases are sufficient, as indicated in the analysis above.

States should also act to allow the necessary pooling arrangements to ensure the costs of terrorism incidents are spread widely. States should consider creation of reinsurance facilities for this purpose.

To the extent that some insurers stop offering terrorism coverage, which is doubtful given the history of the terrorism insurance market in 2002 prior to the enactment of TRIA, assistance for businesses seeking coverage should be provided. Market Assistance Plans (MAPs) have served this function well in previous market dislocations. A MAP is a state government sponsored facility where businesses seeking insurance but having difficulty finding an insurer to write the risk be put in touch with private insurance entities that specialize in the insurance product being sought. MAPS have worked to put willing buyers and willing sellers together when markets have been tight.

CONCLUSION

TRIA is no longer needed.

Most of the country has no significant terrorism risk. The private sector will be covering the entire risk by 2005 in most of the nation (that part in Tier 3 of ISO's model). The only question is whether nine cities, identified by ISO experts as the most likely target areas for terrorist attacks, need any taxpayer support beyond 2005.

CFA believes that there is no need for taxpayer back up after 2005.

However, if any back-up beyond 2005 is considered by Congress, it should be targeted at the cities where the risk is high, encourage private insurance mechanisms to quickly take over the risk, only back up truly large terrorism events such as WMD attacks, and result in no overall cost to the taxpayer.

PREPARED STATEMENT OF JOHN J. DEGNAN

VICE CHAIRMAN AND CHIEF ADMINISTRATIVE OFFICER
THE CHUBB CORPORATION
ON BEHALF OF
AMERICAN INSURANCE ASSOCIATION,
COUNCIL OF INSURANCE AGENTS & BROKERS,
THE FINANCIAL SERVICES ROUNDTABLE,
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA,
NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES,
NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS,
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA,
REINSURANCE ASSOCIATION OF AMERICA,
SURETY ASSOCIATION OF AMERICA, AND
UWC—STRATEGIC SERVICES ON UNEMPLOYMENT & WORKERS' COMPENSATION

MAY 18, 2004

Thank you Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, for your leadership on this important issue of the Terrorism Risk Insurance Program, a program created by the Terrorism Risk Insurance Act of 2002 (TRIA) and that forms a critical element of our Nation's economic security against the clear and present danger we face. My name is John Degnan and I am Vice Chairman and Chief Administrative Officer of The Chubb Corporation (Chubb). I appear before you today representing our national property-casualty insurance trade association, the American Insurance Association (AIA), and a broad coalition of property-casualty insurance trade associations. Together, and for the reasons I will describe, we urge you to extend TRIA for an additional 2 years so that the market for terrorism risk insurance remains stable while legislators, regulators, the insurance industry, and U.S. businesses assess available data (including data from all 3 years of the program) and develop a long-term solution to manage terrorism risk. Enacting an extension now is very important so that: (1) the insurance business cycle is not disturbed; (2) the financial solvency of the insurance industry and its ability to respond to other catastrophes is shielded from terrorist attack; and (3) U.S. businesses remain confident that terrorism coverage will continue to be available and affordable.

The national trade associations on whose behalf I appear before you today represent virtually the entire property-casualty insurance industry, writing all lines of business in every jurisdiction in the United States. Their members, including Chubb, offer various types of insurance that provide coverage for terrorism risk pursuant to TRIA. TRIA has helped stabilize the private market for terrorism risk insurance. As the annual renewal cycle for 2005 commercial insurance policies begins this summer and TRIA's "hard" expiration date of year-end 2005 looms, insurers will be forced to make underwriting decisions without the certainty of the Federal backstop provided by TRIA. Moreover, where that coverage is made available for time periods subsequent to TRIA's expiration, the property-casualty insurance industry will be put at risk. For these reasons, all signs point to a return to the significant market instability that characterized the post-September 11 insurance market before the passage of TRIA. A return to the pre-TRIA insurance market will have a significant negative effect on the national economy, including employment, similar to that we saw prior to TRIA when billions of dollars of commercial transactions stalled because insurers did not have the capacity necessary to provide commercial property-casualty insurance that included coverage for terrorism losses. Accordingly, we urge Congress to extend TRIA now. A 2-year extension this year will help avoid destabilizing the insurance market, and, in turn, the national economy, and will enable Congress, insurers, businesses, and government officials to gather all available, relevant data—including market data from all 3 years of TRIA as insurer deductibles rise from 7 percent of prior year commercial premiums in 2003 to 15 percent of such premiums in 2005, to analyze that data without fear of market disruption, and to collectively develop a more permanent solution for managing our Nation's economic exposure to catastrophic terrorism. Congressional action now will avoid a premature expiration of the Federal backstop based on an analysis of incomplete information about TRIA's impact and the nature of the terrorism risk insurance market and the risk itself.

The tragic attack of September 11, 2001 forced all Americans to directly confront the previously unforeseen realities associated with a catastrophic terrorist attack on

U.S. soil aimed primarily at civilians. The attack resulted in the most expensive insured loss, natural or man-made, in U.S. history. Insurers responded to September 11 claims in an unwavering manner, and without the benefit of a single dollar of Federal assistance. However, the devastating economic consequences of the attack, the specter of future terrorist attacks and the loss of available reinsurance for terrorism left insurers faced with the real possibility of financial devastation in the event of another attack of a similar magnitude. The attack also dramatically altered the future landscape of terrorism risk capacity and insurability, leaving no ready mechanisms to stabilize the market. Insurers and other businesses were forced to reexamine the nature of terrorism-related risks, as well as how such risks (which now more closely resemble war than any other peril) were being spread and managed. In a number of instances, as a matter of financial survival, insurers had no choice but to restrict the amount of insurance they made available for terrorism losses, as the risk was viewed as uninsurable and there was no market certainty. Congress provided definitional parameters of the terrorism risk and some capacity by enacting TRIA in November 2002, which enabled insurers to return to the market with some financial protection.

TRIA sets up a public/private "shared loss" mechanism whereby insurers are required to make commercial insurance available for losses caused by acts of foreign terrorism against U.S. targets to the same extent that they provide insurance for other types of insured losses. For workers' compensation insurance, coverage for terrorism risk is mandatory, as current State laws generally do not permit insurers to exclude coverage for war or terrorism risk. In addition, 22 States currently require insurers to provide coverage for damage caused by fire following a terrorism event and while some of these State laws provide exceptions for fire following "TRIA-type" terrorism, TRIA's expiration could jeopardize those exceptions. Insurers are permitted to charge for the coverage they "make available" pursuant to TRIA, subject to existing State law and regulatory approval, and policyholders are free to reject it, except where the coverage is required by State law. TRIA's mandatory availability provision runs through 2004 and Treasury has until this September to extend the provision through 2005.

In the event of a terrorist act, the Federal Government will assist the insurance industry in paying 90 percent of the resulting insured losses, provided: (1) the Treasury Secretary certifies that an "act of terrorism" occurred; (2) insurers have complied with TRIA's conditions for payment of the Federal share, including TRIA's "make available" and policyholder disclosure requirements; and (3) insurers have incurred losses in excess of an annual individual deductible, calculated as a percentage of the prior year's direct earned premium for covered commercial insurance lines. The insurer deductible started at 7 percent in 2003, is 10 percent this year, and rises to 15 percent in 2005. The public/private shared loss under the program is subject to an annual statutory limit of $100 billion, with every dollar up to that limit either being wholly or partially paid by property-casualty insurers.

In essence, TRIA creates a Federal backstop to the private commercial property-casualty insurance system in the event of further catastrophic terrorist attacks, and provides some market certainty by establishing statutory caps for insured terrorism losses that apply to both the insurance industry and the Federal Government.

There is no question that TRIA has helped stabilize the terrorism insurance marketplace. Since TRIA's enactment, affordable terrorism risk insurance has been more readily available to commercial policyholders, as insurers have passed on the benefit of the backstop to consumers. This market-stabilizing effect enabled billions of dollars of business transactions previously stalled to go forward without threatening the solvency of the commercial enterprises involved or their insurers. A recent Mortgage Bankers Association (MBA) survey of its 40 largest commercial/multifamily mortgage banking firms revealed that a substantial majority of those survey respondents believe that TRIA has made terrorism insurance both more available and less expensive. MBA also noted that failure to extend TRIA would likely have an adverse impact on the commercial real estate market by recreating the pre-TRIA environment that had led to rating agency downgrades of commercial mortgage-backed securities due to lack of adequate terrorism insurance. *Statement of the Mortgage Bankers Association, Joint Hearing of the House Financial Services Committee's Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises and Subcommittee on Oversight and Investigations, "A Review of TRIA and its Effect on the Economy: Helping America Move Forward," at pp. 2–3 (April 28, 2004).*

TRIA also has helped insurers manage exposure to terrorism risk, and write or renew high-risk policyholders that might have been uninsurable (or only insurable on unfavorable terms) without TRIA. This is because TRIA provides individual insurance companies with some certainty as to the dollar amount of risk that they retain. Moreover, TRIA's thoughtful use of the insurance industry's infrastructure to deliver the Federal share of compensation to impacted businesses has allowed Treasury to establish and administer the program with minimal investment and ongoing expense. There is no doubt that the stability TRIA provides to policyholders and insurers alike has calmed a market struggling to come to terms with the uncertainties of 21st century terrorism and its ongoing challenge to our homeland security apparatus.

While TRIA was designed to be a 3-year bridge to development of what was envisioned as a functional, wholly private sector terrorism insurance market, TRIA has not—and indeed cannot—change the underlying characteristics of terrorism risk in the United States. These characteristics weigh heavily in favor of a continued Federal terrorism insurance backstop.

The Commercial Property-Casualty Insurance Sector Continues to Lack both the Necessary Capacity and Sufficient Marketplace Data to Handle Catastrophic Terrorism Losses on its Own

Under certain event scenarios, estimated insured losses from another catastrophic terrorist attack on U.S. soil could exceed $250 billion. *Tillinghast Towers Perrin, Workers' Compensation Terrorism Reinsurance Pool Feasibility Study, Summary of Study Findings and Conclusions, p. V (2004) (Terrorism experts have developed plausible scenarios in which the estimated total insured losses from a single event could exceed $250 billion.).* For example, if the World Trade Center attack had occurred later in the day at lower floors, the losses could have been two to three times as severe. These levels would approach the entire commercial property-casualty industry's estimated capacity of about $150 billion; capacity needed to back all commercial risk. Obviously, the risk of financial ruin for the industry—and the concomitant impact on policyholders, the U.S. economy, and national security—is simply too great, absent continuation of a Federal backstop. Because insurers must be able to respond to multiple insured events, sometimes in a short time frame, the traditional risk spreading mechanism of reinsurance is essential. A significant terrorism event, the consequences of which can no longer be spread through reinsurance, will compromise the industry's ability to respond to a subsequent hurricane or other natural catastrophe.

Moreover, private market mechanisms remain insufficient to spread the risk of catastrophic terrorism in a meaningful way. In its recently released Workers' Compensation Terrorism Reinsurance Pool Feasibility Study, Tillinghast Towers Perrin cited "lack of capacity" as the primary reason why a voluntary workers' compensation terrorism reinsurance pool would not be a viable mechanism to handle megaterrorism risk. This conclusion is not unique to workers' compensation insurance, but would apply to the ability of a pool to address catastrophic terrorism in other lines such as property and business interruption.

TRIA's mandated study—to assess the program's effectiveness, the likely capacity of the private terrorism risk insurance market after TRIA expires, and the affordability and availability of terrorism coverage—is only in its initial phase and will be delivered to Congress by Treasury in mid-2005, just months before TRIA is to sunset. Even then, because the prior year's market data tends to be available in the first or second quarter of the subsequent year, Treasury will have little opportunity to analyze 2004 data before the June 30, 2005 statutory reporting deadline. Equally important, Treasury will not be able to assess market data from 2005, when insurers must take into account deductibles that rise to 15 percent of the prior year's direct earned premium from TRIA-covered lines. Should Congress defer a decision on a TRIA extension until mid-year 2005, insurers, businesses, and Government officials will not have sufficient time to act on any recommendations and insurers will have no choice but to act now, under the assumption that TRIA will not be extended. Congress, other governmental officials, insurers, and the businesses they insure need time to consider all available data—the results of studies undertaken by Treasury and others—and to implement a thoughtful and more permanent solution to the terrorism problem, without the "Sword of Damocles" in the form of financial devastation, hanging over their heads. The stabilizing effects of TRIA must remain in place.

Because the United States Continues to be on High Alert for the Constant and Very Real Threat of Further Attacks, Catastrophic Terrorism Remains an Uninsurable Risk in the Traditional Insurance Marketplace

The Administration has repeatedly alerted Americans to the increased possibility of terrorist attacks. Since September 11 2001, the United States has been on a constant high state of alert for terrorist activity. In fact, New York remains on an even higher alert level than the rest of the Nation. In addition, both Department of Homeland Security Secretary Tom Ridge and National Security Adviser Condoleezza Rice recently warned of possible attempts at terrorist activity in the United States during this election campaign season. And, as President Bush has reminded us, we are engaged in a long-term war on terrorism and the situation is not expected to improve before TRIA's currently scheduled expiration date. War and terrorism are not fortuitous. Acts of terrorism, like acts of war, are premeditated, planned, and executed with a specific purpose by individuals (in the case of terrorism) and governments (in the case of war) that have no interest in predictability, discernable pattern, or advance warning. As war and terrorism are risks of the same character, both types of risk are uninsurable for the same reasons.

To Date, Terrorism Risk Cannot be Modeled or Predicted with any Accuracy

Natural catastrophe modeling does not aid the terrorism modeling process. Modeling for natural catastrophes is far more mature than terrorism modeling. Past natural catastrophes are predictive of the nature, frequency, and severity of future natural catastrophes. Most natural disasters also occur with at least some prior warning. Because of this element, insurers can track when and where natural catastrophes are likely to strike, the type of damage they will cause, and which areas are most vulnerable.

Unfortunately, the same cannot be said for terrorism. Past terrorist attacks are not predictive of future terrorist attacks and the full range of possible terrorist attacks can never truly be known. Terrorists rely on surprise to maximize the impact of an attack, so the attack usually comes without warning. In fact, whether an event is a "terrorism" attack might not be known until after it occurs. This "man-made" threat, which is limited only by the imagination of a terrorist, is one that simply cannot be forecast.

The relative infancy of terrorism modeling contributes to the risk's uninsurability. While modeling firms have worked diligently to produce terrorism risk models to predict terrorism events in the United States, they have not been able to model accurately for the frequency of terrorist attacks, because it is the terrorists who alone control that variable. These models instead focus only on predicting the impact terrorism has on its victims. Office towers can be built or retrofitted to withstand earthquakes in Los Angeles or hurricanes in Miami (making them more insurable), but few businesses would want to turn their offices into hardened bunkers. Even then, terrorist excel in adapting to overcome such loss mitigation measures.

The possibility of nuclear, biological, chemical, or radiological attacks (NBCR) reinforces the conclusion that catastrophic terrorism risks are uninsurable. NBCR demonstrates that even the severity component of a terrorist attack is difficult to predict. Potential terrorism scenarios now routinely include discussion of NBCR events. The anthrax attacks perpetrated through the U.S. postal system, (including the U.S. Senate's own mail facility), even though limited in scope and severity, only serve to underscore the random quality and myriad potential consequences associated with such events. As a result, insurers remain reluctant to provide NBCR coverage for terrorism risks in their policies beyond that required in workers' compensation insurance or already "made-available" for other types of insured loss.

Unlike Other Risks of Loss, Terrorism is an Interdependent Risk

Loss control or mitigation techniques employed by one commercial business may not protect that business from catastrophic loss. The World Trade Center is the most compelling—but not the only—example of the interdependent nature of terrorism risk. The World Trade Center was a model of security and disaster planning, yet nothing done at the World Trade Center could have prevented planes leaving airports with hijackers aboard, and nothing done at the World Trade Center could have prevented planes being used as weapons from flying into the towers. The interdependent nature of terrorism risk, with vulnerability measured by the weakest link in the chain, minimizes the effectiveness of even the best business-by-business loss control programs.

Information about Terrorism Risk is Incomplete

Contrary to traditional evaluation of insurance risks, information availability and sharing about terrorism risk is asymmetric. Insurers and policyholders do not have access to classified information in the hands of the U.S. Government, and therefore cannot evaluate the risk of terrorism properly. This "information vacuum" makes risk transfer and management decisions about terrorism a dicey proposition.

Because of these characteristics, terrorism risk defies normal underwriting and rating principles, effectively limiting the ability of property-casualty insurers to advance a private mechanism for that risk. The combination of these intrinsic characteristics of terrorism risk argues in favor of a Federal backstop that will provide both certainty and stability to the marketplace. A Federal backstop will also help mitigate the continuing absence of a viable reinsurance market. During the policy renewal period following September 11, 2001, reinsurers largely declined to provide capacity against the risk of foreign terrorism in the United States. Reinsurers continue to consider terrorism risk uninsurable in the traditional sense, and are not expected to provide the market with sufficient capacity when TRIA expires. Thus, the Federal Government must continue the role it has filled under TRIA: Supplying capacity that is unavailable in the private reinsurance market in order to provide the reinsurance protection that is critical as long as even a possibility for catastrophic loss exists.

Aside from the inherent systemic issues associated with insuring catastrophic terrorism and the insufficient capacity reinsurers are able to bring to the market, there is strong consensus among commercial policyholders, State insurance regulators, and the insurance industry that continuation of a Federal backstop is essential. There also is strong consensus that, because of insurance and business cycles, extension simply cannot wait. Congress must take action in 2004 in order to avoid the kind of market dislocation that was so destabilizing prior to TRIA's initial passage. The national trade associations that I am testifying on behalf of today are united in support of a 2-year TRIA extension that will continue the pattern of certainty and stability, while giving all parties the time necessary to determine the best mechanism for managing terrorism risk and preserving national economic security should such an event occur in the future.

The devastating results of the September 11 attack illustrate the significant threat that terrorism poses to the security of the Nation's fiscal health. Businesses—particularly those considered critical to the Nation's infrastructure—must be ever mindful of the devastating impact that a terrorist attack can have on their financial condition and prospects for survival, as well as the catastrophic ripple effect that cascading business failures could have on the economy. This is especially true of the U.S. property-casualty insurance industry. After September 11, the possibility of future terrorist attacks and the loss of available reinsurance for terrorism risk left insurers facing the very real possibility of financial ruin should another event of similar magnitude occur. TRIA helped to significantly ease that financial "Catch–22."

We urge Congress to take immediate action to extend TRIA for an additional 2 years for several important and inter-related reasons discussed below.

TRIA's "Hard" End Date is Inconsistent with Rolling Expiration Dates Provided by Underlying Insurance Policies

TRIA has a "hard" expiration date of December 31, 2005, after which date Treasury will be unable to certify any terrorist act. By contrast, the underlying insurance policies that rely on TRIA are written every day of the year, generally for a 12-month term (although some commercial property insurance policies covered by TRIA are multiyear). This sequential mismatch will create confusion for policyholders and uncertainty for insurers, because policies written before, but extending beyond, December 31, 2005 will have a coverage term that extends beyond the backstop. As a result, insurers will have no choice but to evaluate every policyholder considered for coverage during this period as if the backstop does not exist for at least part of the coverage period.

Treasury's "Make-Available" Decision Adds to the Uncertainty

TRIA directs Treasury to decide by September 2004 whether to extend current "make-available" provisions to 2005, the third year of the program. A number of business groups have publicly urged extension of the "make-available" requirement, because the private terrorism insurance market is not fully stable and is likely to destabilize in TRIA's absence. Insurers have expressed concern about the potential mismatch between policies sold during 2005 and the hard sunset date. For example, if "make-available" were extended through 2005, carriers would be required to "make-available" terrorism insurance on policies becoming effective on December 1, 2005, even though TRIA would remain in effect for only *one month.* The ensuing confusion in terms of coverage, premiums charged, and exposures being assumed will significantly disrupt the insurance market, particularly for workers' compensation and commercial property insurance. Despite somewhat differing perspectives on the "make-available" requirement, policyholders and insurers agree that it is critical to extend the backstop beyond December 31, 2005. Securing the extension in 2004, rather than 2005, would avoid difficult implementation of the "make-available" provision during the third year of the program.

The hard end dates for "make-available" (December 31, 2004, unless extended by Treasury) and TRIA protection (December 31, 2005) do not coincide with State regulatory requirements or implementation timelines of property-casualty insurers. Post-TRIA policy forms must be approved by most of the States prior to their use in the market, and that process has already started. New forms submitted for State regulatory review must delineate the scope (if any) of terrorism coverage provided in the policy. Without a doubt, some of those policy forms are premised on TRIA expiring at the end of 2005. In many States, insureds must be notified of any unfavorable changes to the coverage being provided under their policies, including the terrorism coverage afforded because of TRIA, at least 30 (and in some cases up to 75 or 90 days) days prior to the renewal date for their policy. This effectively means that insurers must start notifying insureds of the changes occasioned by TRIA's expiration in October 2004, because 1 year policies incepting in January 2005 may very well not have TRIA terrorism coverage for at least that part of their term that extends in 2006.

State cancellation/nonrenewal requirements add more complexity. Insurers that cancel or nonrenew certain policyholders because of concern about post-TRIA exposure levels will have to comply with a myriad of State cancellation and nonrenewal notification requirements, generally ranging from 30 days to 90 days. Carriers that are unable or unwilling to offer the capacity for workers' compensation and/or commercial property insurance (that, by law, must include at least some insurance for terrorism) to insureds that have significant terrorism exposures will have no choice but to cancel or nonrenew these policies, causing additional market disruption. Policyholders who receive such notices will need to seek out other insurers from whom they can obtain needed coverage.

ONCE POLICY FORMS ARE APPROVED, SYSTEM CHANGES MUST BE IMPLEMENTED

New policy forms (along with any required policyholder notices) will need to be loaded into insurance company systems, a process that often takes several months, because many States typically require State-specific policy language (resulting in multiple versions of the same form) and have State-specific notice requirements. These changes must be in place before any policies using the new forms can be underwritten consistent with State regulatory requirements.

Implementation of new policy forms will affect the full range of commercial policyholders. For large commercial policyholders, the underwriting process will take several months. Many of the large commercial policyholders that benefit most from TRIA have relatively complex insurance arrangements that generally require 2 to 3 months of negotiation prior to being finalized. As a result, the first policies that are likely to be affected by TRIA's "hard" sunset (that is, those that are up for renewal subsequent to January 1, 2005) will be negotiated in the late summer or early fall of 2004. In addition, ongoing uncertainties surrounding TRIA's hard sunset date may more immediately and adversely impact small to mid-size commercial insurance policyholders. These businesses comprise the majority of the commercial lines marketplace. They rely on TRIA perhaps to a greater extent than many of their larger counterparts, because their operating margins are thinner, and they have less leverage in the marketplace.

INSURANCE, THE UNDERPINNING OF THE U.S. INFRASTRUCTURE, NEEDS A TRIA EXTENSION UNTIL A LONG-TERM SOLUTION IS IN PLACE

Commercial insurance spreads risk for all critical U.S. infrastructures. If the solvency of the insurance industry were compromised, the ramifications for the U.S. economy and national security would be catastrophic. Indeed, the importance of property-casualty insurance to the physical and economic infrastructure of the United States cannot be overemphasized. Insurance helps immunize the U.S. economy from the adverse effects of the risks inherent in economic growth and development. Insurance also provides the funding necessary to rebuild physical and economic infrastructure in the event of catastrophic losses to persons or property, whether caused by hurricane, earthquake, fire, defective products, or other calamity. Examples of the necessity of insurance to the Nation's critical infrastructure abound in every significant economic sector, including:

Construction

Construction projects cannot go forward unless property-casualty insurance is in place to protect against loss arising out of construction activities. Without insurance in place, contractors engaged in building projects will not build (because surety bonds are not available); permits will not be issued (because most statutes require "builder's risk" and contractor's liability insurance); necessary financing cannot be obtained (because lenders typically require insurance as a condition to lending money) and work cannot commence (because workers' compensation insurance is a statutory workplace requirement).

Commercial Lending

Businesses cannot obtain financing for property acquisitions or new business initiatives, because property-casualty insurance is an essential prerequisite for mortgage and other commercial lending activities.

Real Estate Development and Commercial Leasing Activities

These activities account for nearly one-quarter of U.S. Gross Domestic Product. The inability of tenants to obtain property-casualty insurance to protect owners of office buildings and other commercial properties frustrates these activities and causes significant economic dislocation, particularly in urban areas, as demonstrated by the dramatic slowdown in the New York City real estate market after September 11.

Employment

Businesses cannot employ workers without providing them workers' compensation insurance.

Transportation, Shipping and Transit

Motor vehicles (including trucks, buses and cars) cannot be operated on public roads without property-casualty insurance because proof of financial responsibility (in the form of insurance) is a statutory prerequisite.

Business Recovery

In the event a business sustains a property loss to its production facility (for example, in the form of a fire), property-casualty insurance provides that business with the money necessary to: (1) rebuild the property lost by the fire; (2) preserve its income stream while the property is being repaired and its operations are being restored; and (3) meet its payroll obligations to its employees. Without such insurance, employees could very well lose their jobs if the business cannot recover from the property and income losses sustained from the fire.

Research and Development

The development of pharmaceuticals, software, and other new products, requires companies to put business assets at risk and expose themselves to new liabilities. Property-casualty insurance allows businesses to protect against first party losses to new product prototypes, shields against new legal liabilities created by introducing new products into the stream of commerce, and to otherwise "hedge" against the risks inherent in innovation and invention.

Global Commerce

Property-casualty insurance plays a critical role in global commerce. The international partners of U.S. businesses and the legal requirements of other countries make the continued availability and affordability of property-casualty insurance essential to preserving this Nation's place in global markets.

Terrorism risk is exactly the kind of problem that threatens to compromise U.S. critical infrastructure. The potential for catastrophic terrorism loss, especially without the benefit of a Federal backstop, exacerbates the solvency challenges faced by insurers. As noted earlier and based on figures provided by the Insurance Information Institute in its III Fact Book for 2004, currently the U.S. property-casualty insurance industry has approximately $300 billion in surplus. Roughly half that figure represents monies set aside to cover homeowners and automobile insurance losses, leaving approximately $150 billion to support all types of commercial insurance losses, including (but not limited to) losses from terrorism. If an event of greater magnitude than the September 11 attack were to occur, the ramifications for the insurance industry, the U.S. economy, and U.S. national security could be dire. Moreover, if the U.S. property-casualty insurance industry were to become insolvent, the economic reverberations would be felt throughout the world.

In short, without a robust and financially sound property-casualty insurance industry, none of the other aforementioned critical infrastructure industries—which look to their insurers in the event of a loss to make them "whole" again—would be able to recover economically from a major terrorist attack, or for that matter, from any other type of catastrophe. One terrorist attack may very well be enough to render the insurance industry unable to absorb a subsequent catastrophic loss of any kind.

Conclusion

TRIA's public-private partnership is working to stabilize the commercial insurance markets that underpin our entrepreneurial, free-market economy. However, because war and terrorism are societal risks, they remain uninsurable. The aim of a terrorist is not to hurt the insured, but rather to attack the United States. To ask the insurance industry to absorb loss resulting from an attack against our Nation (one directed at the United States to alter its behavior) places the U.S. economy and our national security at great risk. Without a risk-spreading mechanism, the right attack could very well bring the insurance industry to its knees and significantly destabilize our economic infrastructure, achieving a primary aim of the terrorist. We simply cannot afford to let TRIA expire and leave this important matter to chance. A 2-year extension is critical.

TRIA must be extended in a manner that: (1) avoids the types of market dislocations it was designed to address; (2) protects our ability to both recover economically from a terrorism loss and respond to other catastrophic events that take place thereafter; and (3) allows insurers, businesses, and government officials to develop a more permanent solution to the terrorism insurance problem. Because of the regulatory and operational lags that are inherent in the insurance system, Congress must act in 2004, even though the law itself does not expire until year-end 2005.

Thank you for this opportunity to explain the importance of a 2-year TRIA extension.

PREPARED STATEMENT OF CHRISTOPHER NASSETTA

PRESIDENT AND CHIEF EXECUTIVE OFFICER

HOST MARRIOTT CORPORATION

ON BEHALF OF

THE COALITION TO INSURE AGAINST TERRORISM

MAY 18, 2004

Chairman Shelby, Ranking Member Sarbanes and Senators, good morning, my name is Christopher Nassetta. I am CEO of Host Marriott, which owns or has interests in over 230 hotels in 34 States and the District of Columbia, and is a publicly traded real estate investment trust. I am appearing today on behalf of the Coalition to Insure Against Terrorism (CIAT).[1]

CIAT Representing Consumers of Commercial Insurance

CIAT is a broad coalition of insurance consumers that was formed in the months following September 11 to ensure that American businesses could obtain comprehensive and affordable terrorism insurance. As part of its effort, CIAT joined with the Administration and those in Congress who recognized that only the Federal Government could provide the framework to make this coverage available to all those who required it. The diverse CIAT membership covers virtually every sector of the private economy as well as public sector buyers of insurance. For example, the U.S. Chamber of Commerce, the National Association of Manufacturers, and the National Retail Federation are members. So are, to name a few sectors, transportation interests (for example, the Association of American Railroads, the General Aviation Manufacturers Association, and the Taxicab, Limousine, and Paratransit Association), utilities (for example, American Gas Association, American Public Power Association, Edison Electric Institute, and National Rural Electric Cooperative Association), finance (for example, American Bankers Association, America's Community Bankers, Mortgage Bankers Association of America), real estate (American Resort Development Association, National Association of REALTORS®, Building Owners and Manufacturers International, International Council of Shopping Centers, and National Association of Industrial and Office Properties) and sports (for example, the Baseball Commissioner, NCAA, NBA, NFL, and NHL). A full list of CIAT's member trade associations as well as other members accompanies my written testimony.

Collectively, the business and governmental organizations represented by the CIAT membership are the principal consumers of commercial property and casualty insurance in America, and therefore it is accurate to say that the voice we provide today is the true consumer voice with respect to the subject of today's hearing.

After September 11, TRIA Became Indispensable

My own company Host Marriott does not come to this subject untouched by terrorism. We and our employees were deeply and personally affected by the terror attacks of September 11. Although we were not specifically targeted by the terrorists,

[1] I am also a board member of The Real Estate Roundtable (The Roundtable) and a member of the executive committee and treasurer of the National Association of Real Estate Investment Trusts (NAREIT). Both The Roundtable and NAREIT are CIAT members.

we did not escape the terrible consequences of their acts. Host Marriott lost our 820-room Marriott World Trade Center Hotel which was completely destroyed, and our Marriott New York Financial Center Hotel was heavily damaged. Much more importantly, we suffered the loss of two hotel employees and eleven hotel guests were unaccounted for.

After first addressing the human issues, we needed to reassure markets that our properties were fully insured, and I spent many hours on the phone with shareholders and analysts. In each instance, they wanted to know whether our policies fully covered terrorist attacks. Fortunately, our property and casualty policies then in effect did cover losses resulting from acts of terrorism. After the horrific attacks, the insurance market changed dramatically. Terrorism risk was excluded from renewal offers on most of our policies, and the only coverage we could find was either "stand-alone" policies or "buy-back" endorsements, and such policies left us with considerably less protection than we had before September 11.

All of CIAT's members were united in their support for the enactment of the Terrorism Risk Insurance Act of 2002. All remain equally determined to see the TRIA program continue for the intermediate term because the conditions that made it necessary still are with us. The threat of foreign terrorist acts in the United States has not diminished; if anything, it may have increased since TRIA was enacted. At the same time, the insurance market has not recovered, at least not with respect to this peril. While some limited reinsurance capacity has returned, nothing near what is needed to sustain the economy is foreseeable under current conditions.

In today's world, CIAT believes TRIA or something like it has become indispensable. That is because our economy and businesses are at risk for unique man-made catastrophic events of unknown dimension and frequency which the insurance industry is unprepared, understandably, to handle on its own. Our national leaders tell us repeatedly that terrorism will be a threat to us for the foreseeable future. At the same time, our Nation is undertaking significant efforts both to prevent and to prepare for terrorism. We believe that TRIA is an important component of this national effort, as TRIA both helps the economy move forward in the face of terrorism and helps us prepare economically should there be another catastrophic event. Without TRIA we believe the wheels of commerce, including the active development of new businesses and the jobs they bring with them, will be slowed jeopardizing our Nation's economic security.

On behalf of CIAT's members, let me thank this Committee and the entire Senate for enacting this successful law. But I would be remiss if I did not specifically acknowledge that the President provided critical personal leadership in getting the program enacted. President Bush recognized the importance of this effort, not just from the perspective of an insurance market unable to underwrite accurately and assume the whole risk, but because he knew our economy needed to be secure then and in the future. We thank you and him for these efforts. They succeeded well.

Importance of Immediate Extension of "Make-Available"

Before I explain how TRIA has succeeded, I would like to address a pressing and related matter. The members of CIAT are increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of the Treasury moves affirmatively to extend the so-called "make-available" provision in TRIA. The Act provides that he is to make this determination by September 1, 2004. If the "make-available" provision is allowed to expire this year, American businesses face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether—*a full year* earlier than TRIA's termination date. Further, it is likely that financial markets will react negatively in the final quarter of 2004 to the prospect that insurance may not be available.

Absent an extension, primary insurers would no longer be mandated to make terrorism insurance available on the same terms and conditions as other insurance. Although we had hoped initially, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would emerge in a post-September 11 TRIA environment, this has not happened. Consequently, we are seriously concerned that with the absence of a "mandate" in 2005 under TRIA and with the paucity of private market reinsurance available, primary insurers will not offer, or "make-available," significant, comprehensive terrorism insurance for the 2005 marketplace. In fact, we know from the example of the continuing exclusion of biological, chemical, radiological, and nuclear risks how markets will react if there is no mandate (and continuation of backstop).

Accordingly, I respectfully urge Members of this Committee and indeed all of the Senate to recommend to the Secretary of the Treasury that he extend the vital "make-available" provision of TRIA this year. A bipartisan effort already is under-way in the House in calling on Treasury Secretary Snow to extend the "make-available" provision of TRIA for the third year of the Program. These House Members have urged the Secretary to take that action as soon as possible rather than leave it for the September 1 deadline. This will ensure that the insurance industry will be prepared in 2005 to provide American businesses with one of the crucial tools necessary to help protect the American economy and American jobs from the ugly and harmful specter of terrorism.

How TRIA Helped The Market

Prior to September 11, coverage for acts of terrorism was routinely included in all property and liability insurance policies. As I said, after those horrific attacks, terrorism risk was generally excluded from the renewal offers on all of these policies, and the only coverage that could be found was either "stand-alone" policies or "buy-back" endorsements, and even taking up what coverage was offered on those terms left us and others with substantially less protection of our assets and operations than had been the case before September 11. Even when some coverage was available, it was not as broad or secure as before and the costs were dramatically higher. Moreover, there was no consistency or apparent rationality to the prices on various layers and programs of coverage.

With respect to Host Marriott's own program, our property insurance costs nearly tripled in the policy year following September 11, even though on a property portfolio insured for $8.6 billion for other (nonterrorism) perils, we had stand-alone terrorism insurance for only about 3½ percent of that portfolio value, and that now excluded biological, chemical, and radiological risks.

I have no doubt that virtually all other commercial buyers in the market had the same experience as Host Marriott. The consequence of this was not just decreased coverage protection and increased cost for us and other buyers. In many cases, it also meant that we in the business community could not, for example, provide lenders and other business partners with evidence of insurance consistent with loan documentation requirements. This led to a slow-down of development activities, job losses, and other consequences throughout the post-September 11 economy.

After TRIA was enacted the market very quickly normalized, for the most part. The combination of the Federal reinsurance backstop and the law's requirement that all participating property and casualty insurers "make-available" terrorism insurance in every commercial policy, led to restoration in available limits in most cases and, importantly, a return to something like a rational or consistent pricing of this coverage in the market in the 18 months since TRIA came into effect. To be sure, the process has been gradual as insurers, brokers, and buyers have adjusted to the Act's requirements and considered the evolving prices and other terms. The most recent information from Marsh, Inc., the world's largest insurance brokerage firm, shows that the take-up rate for terrorism coverage continues to rise as this adjustment process continues. For example, a recent Marsh study of 2,400 U.S. businesses found that, from the second quarter to the fourth quarter of 2003, the percentage of businesses purchasing terrorism coverage rose another 5.4 percent, from 27.3 percent to 32.7 percent. I believe that if you looked specifically at major businesses or at publicly traded companies with boards and managements subject to Sarbanes-Oxley responsibilities, you would find even higher rates of purchase.

In assessing the success of TRIA, Congress should keep in mind that it is early in the TRIA experience. Consider the comparative experience for other government-backed insurance programs dealing with specific-perils. Two examples are instructive. First, the California Earthquake Authority, which is a publicly managed entity established by the California Legislature to ensure that earthquake coverage is offered to all residential policyholders, reports that just 14–17 percent of eligible California homeowners have earthquake insurance.[2] Second, according to a recent GAO report, the Federal Emergency Management Agency, a unit of the Homeland Security Department, estimates that one-half to two-thirds of property owners in eligible flood-prone areas do not have flood insurance coverage under the National Flood Insurance Program (NFIP), even though NFIP coverage is mandated for all FHA or GSE-backed loans for homes in special flood hazard areas.[3] This participation rate

[2] *Summary Report to the CEA Governing Board: Stakeholder Comments at Roundtable Summit Meetings,* June 6, 2003, p. 5. Available: *www.earthquakeauthority.com/pdfs/FinalRndtbl Rept6–19–03.pdf.*

[3] U.S. General Accounting Office, *Flood Insurance: Challenges Facing the National Flood Insurance Program,* GAO–03–606T (Washington, DC: April 1, 2003). GAO did not attribute the low NFIP participation rate to a lack of need for Federal flood insurance, but rather lack of awareness or information on the part of policyholders and complexity of the NFIP. Similarly the early participation rates under TRIA, in part, may reflect the newness of the program and inexperience or informational deficiencies for both insurers and customers. The increases in partici-

for the NFIP, which has been in operation since 1968, would be roughly comparable to the recent take-up rate reported by Marsh for the new TRIA-backed commercial terrorism insurance. Moreover, the NFIP flood insurance is not evenly distributed across the country. As of March 2001, Florida accounted for roughly 41 percent of total NFIP policies in effect nationwide.

Biological, Chemical, Radiological, and Nuclear Risks

TRIA has certainly led to a general availability of terrorism coverage and has produced relative stability in pricing for that coverage. Unfortunately, it cannot be considered a complete success, from the perspective of CIAT's broad membership, because of the continued exclusion by insurers of biological, chemical, radiological, and nuclear (or B/C/R/N) risks from the terrorism insurance being offered.

In the early months of TRIA, there was some confusion among various parties and even some commentators about whether the TRIA backstop was available for these B/C/R/N risks, whether as WMD's or otherwise. CIAT itself sought and obtained from the TRIA Office an unequivocal affirmation that B/C/R/N terrorism is an insurable risk which will be eligible for indemnification under TRIA.[4]

While this may clear up some misunderstanding that existed on the margins in the market, it is equally clear that most major insurers understand that the indemnification is available for these perils but that they, at least for now, have no plans to offer coverage of B/C/R/N perils because of the deductibles they retain and because of the lack of non-Federal reinsurance. State regulators have, since TRIA was enacted, approved specific exclusion clauses which allow exclusion of most B/C/R/N risks from most commercial lines property and casualty policies. The main exception is workers' compensation where the coverage is defined by statute and is not allowed to exclude these perils.

We point this out not to criticize the insurers, or the State regulators, but to illustrate the still tenuous nature of the market and of the insurance industry's limited capacity or willingness to accept terrorism exposure. We believe this observation only reinforces the conclusion that the private insurance and reinsurance market is not yet ready, nor will it be by 2006, to offer terrorism insurance to the U.S. economy without some continued indemnification from the Government under TRIA. The experience also illustrates that whether coverage is available is largely a function of the interplay of the continued Federal backstop and the mandatory offer or coverage requirements of both State and Federal law.

Critical Importance of 2-Year Extension of Overall Program in 2004

We are staring the calendar in the face. TRIA is currently subject to a scheduled "hard" expiration on December 31, 2005. It is a "hard" expiration in the sense that no terrorist event after that date will be federally indemnified even under a policy which is still in effect on that date and which otherwise covers terrorism. The insurance industry has already proposed to State regulators, through the collective body, Insurance Services Office (ISO), to begin using policy forms beginning January 1, 2005 that would exclude or cut off terrorism coverage on January 1, 2006 on policies that run past that date. (While the calendar year is common in insurance programs, the majority of commercial policies have renewal dates other than January 1.) Worse, our fear is that in many cases insurers may withdraw from particular lines or particular customers rather than bother with negotiating over these "sleeping" exclusions that have been proposed to regulators. Thus, commercial insurance buyers face potentially severe dislocations and availability problems not in 2006 but as soon as negotiations for 2005 insurance programs commence; that is to say, later this year, if the overall TRIA program is not renewed before then.[5]

Thus, we believe that Congress should enact that extension now, this year, to ensure that everyone who needs coverage can buy it. Only this will avoid gaps in availability during the 2004–2005 insurance renewal season. Any uncertainty during the coming year could impair economic activity—especially new commercial construction—and job growth, as clearly occurred between September 11 and November 2002 when TRIA was enacted.

---

pation rates during 2003 reported by Marsh suggest this may be the case rather than lack of ultimate demand for the coverage.

[4] See Terrorism Risk Insurance Program Interpretive Letter, dated March 24, 2004, available on the Department of Treasury's website at: *www.treas.gov/offices/domestic-finance/financial-institution/terrorism-insurance/pdf/redactedci.pdf.*

[5] TRIA calls for a comprehensive study and report by the Treasury Department to Congress in June 2005. Unfortunately, it is now clear that date will be too late for Congressional action, if serious market dislocations are to be avoided. We believe that Treasury study may provide valuable guidance for any eventual long-term solution but should not deter Congress from providing the 2-year extension in the meantime.

A Federal Role Remains Necessary

From CIAT's perspective, TRIA has been not only a great success, but also an economic necessity in helping to manage each industry's—and our Nation's—economic risks from terrorism. Looking forward, we see no evidence that private insurance markets will be able to provide adequate terrorism insurance.

Some claim to know what U.S. cities or buildings are at risk and what areas are not at risk. Neither I nor other CIAT members pretend to have that kind of knowledge. The knowledge we do have is that the terrorist mind is dynamic. Its targets and methods of attack evolve with the conditions. As potential targets harden, other softer targets or geographical areas come into focus. Given this reality it seems shortsighted indeed to try to microdesign a program today for specific risks that we know will evolve in the future. To suggest that terrorism insurance is relevant to only nine U.S. urban areas is ludicrous. Host Marriott has hotels in 34 States and the District of Columbia, and the CIAT coalition has national membership active in all 50 States including rural organizations, such as the rural electric cooperatives, that are vitally concerned with the availability of this insurance coverage. What we need, and need urgently, is a continuation of TRIA, to help us be prepared for whatever might come.

Clearly, terrorism is a risk that arises from persons or groups who have declared war on the United States—making U.S. economic interests at home and abroad the new battleground. Recent attacks in Jakarta, Istanbul, and Spain have demonstrated that terrorists remain intent upon waging this war. As Secretary of Homeland Security Tom Ridge said recently in a speech at the Port of Portland (Oregon):

> [T]he terrorists in part targeted the free and democratic elections in Spain—again striking at the elements of our society that they hate the most. As we enter a season dominated by these symbols—the Olympics, political conventions, and our own presidential election—we must remain on heightened alert so that these very foundations of our freedom do not become targets for the enemy.

However, unlike hurricanes, earthquakes, and floods, we do not know how another attack will manifest itself—we do not know where, when, or how catastrophic an attack will be—all we know is that another attack is likely coming. Despite early attempts by modeling firms to produce terrorism risk models that can accurately predict terrorism events in the United States, they are unable to model accurately for the frequency or severity of such attacks, absent more reliable data. Unfortunately, even as we make every effort to eliminate the threat of terror, the terrorists themselves may substantially influence those variables.

The private sector has not been idle in the meantime. For example, serious work has been done exploring alternatives to TRIA, such as the possibility of a privately funded terrorism reinsurance pool for the workers' compensation insurance market. This is a line of coverage crucial to every employer. The preliminary conclusions, however, suggest that even this may be beyond the capability of the private economy without some Government assistance. At a minimum, more time is needed to develop solutions, and only an extension of TRIA will provide that time.

Whether or not private markets are able to meaningfully price in the future the risks associated with this war, we need to think about what condition insurance markets will be in after another such attack. Insurance is a critical element in the business of this Nation. As we spend billions creating the Department of Homeland Security, we need to consider also the experience and example of other nations, such as the UK, France, Germany, Israel, Austria, South Africa, and Spain—and recognize that this is not solely a "market" issue—clearly, this is a matter of managing the Nation's economic risk and preparing our Nation's economy for war of this nature. Each of these countries, and others, have established ongoing government-aided terrorism insurance (or reinsurance) programs. Attached is an addendum briefly describing each of these foreign programs.

It would be ironic if Congress declined to give the domestic economy the security of knowing next year that the Government will continue to support terrorism insurance risk. That is because Congress has provided long-term insurance protection for U.S. investors against terrorism and other forms of "political violence" when U.S. business invests overseas. The Overseas Private Investment Corporation (OPIC), a Federal Government agency, has been providing this protection to U.S. investors for their overseas projects since 1971.[6] It certainly seems consistent to us that the U.S.

---

[6] OPIC is currently authorized through 2007—two years after TRIA is currently set to expire—but has project commitments, including insurance coverage, for up to 20 years into the future.

Government, while it continues to provide multiyear insurance coverage for acts of terrorism overseas, should also at the very least provide a short-term extension of reinsurance coverage for terrorist events on our own soil. TRIA should be extended at least through the current authorization of the OPIC program, that is 2007. As President Bush has repeatedly reminded us, the war on terrorism is a long-term endeavor, with little expectation that the situation will improve with any certainty before TRIA's currently scheduled expiration date.

Terrorist attacks are not attacks on individual companies or buildings but rather on our national policies and the way of life in America. When considered in this way, it is only natural that a national policy of shared risk be established—and be maintained—until the threat is removed. A major reason that terrorists attack us is to disrupt our economy. Having mechanisms, such as TRIA, in place that allow our economy to continue in the face of threats and to recover from actual attacks, enhances our economic security. This is no time to retreat from what we resolved to do after September 11. As a country we must maintain the efforts which will secure our economy. TRIA is an important part of that national resolve. For these reasons, CIAT urges you to act quickly to extend TRIA for 2 additional years.

Conclusion

TRIA has been a success, and we commend the Chairman and Ranking Member for holding this very important hearing today. We remain concerned, however, that an adequate private reinsurance market for terrorism has not emerged in the 18 months since TRIA's enactment, and for this reason as well as the other reasons stated above, action this year is imperative in two respects: (1) the Treasury Secretary should extend the "make-available" provision as soon as possible; and (2) TRIA should not be allowed to sunset in 2005; rather, Congress should provide a seamless, 2-year extension of TRIA, which contains the "make-available" requirement, before adjournment this year.

Neither we in the private sector nor Congress should sit idle during the time after TRIA is extended. This 2-year extension will give policymakers, insurance markets and their regulators, and we customers the extra time needed to revise or modify the program or to develop a wholly new and more permanent solution to this critical need of the economy. Thank you, Mr. Chairman. I would be happy to respond to the Committee's questions.

CIAT COALITION TO INSURE AGAINST TERRORISM

www.insureagainstterrorism.org

American Bankers Association
American Bankers Insurance Association
American Gas Association
American Hotel and Lodging Association
American Public Power Association
American Resort Development Association Resort Owners' Coalition
American Society of Association Executives
America's Community Bankers
Associated Builders and Contractors
Associated General Contractors of America
Association of American Railroads
Association of Art Museum Directors
The Bond Market Association
Building Owners and Manufacturers International
Boston Properties
CCIM Institute
Chemical Producers and Distributors Association
Commercial Mortgage Securities Association
Edison Electric Institute
Electric Power Supply Association
The Financial Services Roundtable
The Food Marketing Institute
General Aviation Manufacturers Association
Helicopter Association International
Hilton Hotels Corporation
Host Marriott
Independent Electrical Contractors
Institute of Real Estate Management
International Council of Shopping Centers
The Long Island Import Export Association
Marriott International
Mortgage Bankers Association
National Apartment Association
National Association of Home Builders
National Association of Industrial and Office Properties
National Association of Manufacturers
National Association of REALTORS®
National Association of Real Estate Investment Trusts
National Association of Waterfront Employers
National Association of Wholesaler-Distributors
National Basketball Association
National Collegiate Athletic Association
National Council of Chain Restaurants
National Football League
National Hockey League
National Multi Housing Council
National Petrochemical & Refiners Association
National Restaurant Association
National Retail Federation
National Roofing Contractors Association
National Rural Electric Cooperative Association
The New England Council
New York City Partnership
Office of the Commissioner of Baseball
Public Utilities Risk Management Association
The Real Estate Board of New York
The Real Estate Roundtable
Six Continents Hotels
Society of American Florists
Starwood Hotels and Resorts
Taxicab, Limousine & Paratransit Association
Travel Business Round Table
UJA-Federation of New York
Union Pacific Corporation
U.S. Chamber of Commerce
Westfield

Summary of Selected Foreign Terrorism Insurance Programs

Country	Description of Program
United Kingdom	***Pool Re.*** Operational since 1993, Pool Re is mutually owned by participating insurers. Under the program, primary insurers reinsure their terrorism risks with Pool Re, which sets premiums based on the amount of coverage, geographic location and other risk factors. Pool Re is required to insure all offered policies. In turn, the British Government reinsures Pool Re and accepts liability for all of the claims above Pool Re's ability to pay. Despite the pool's numerous claims over the years, there has never been a draw on the Treasury.
France	***Gestion de l'Assurance et de la Réassurance des Risques Attentats (GAREAT).*** Created in 2002, GAREAT is a reinsurance pool covering commercial and industrial risks for direct property losses and business interruption arising from acts of terrorism, where the sum insured exceeds € 6 million. Terrorism insurance is compulsory. Membership in GAREAT is not mandatory, but is automatic for insurers affiliated to FFSA (the national association of insurance companies in France) and GEMA (the main trade association for mutuals). The government-controlled Caisse Centrale de Réassurance (CCR) acts as a reinsurer of last resort when annual aggregate losses are in excess of € 1.75 billion.
Germany	***Extremus AG.*** Created in September 2002, Extremus AG offers terrorism coverage for property damage and business interruption losses in the Federal Republic of Germany where the sum insured exceeds € 25 million. About 50 insurers and reinsurers participate and will cover damages up to € 3 billion, while the German government will be liable for up to € 10 billion beyond the first € 3 billion. Terrorism insurance is optional.
Spain	***Consorcio de Compensación de Seguros (CCS).*** The state-owned CCS was originally set up in 1941 to cover against losses from the Spanish Civil War, and became a permanent cover against catastrophic losses (including terrorism, but also earthquake, flood, etc.) in 1954. Coverage of catastrophic risks became compulsory within all policies covering property damage and bodily injury. Following 9/11, CCS agreed to reinsure terrorism risks with respect to business interruption on all risks located in Spain.
South Africa	***South African Special Risk Insurance Association (SASRIA).*** SASRIA has been operating since 1976 covering commercial and private lines and insuring against politically motivated riots, non-politically motivated riots, strike and public disorders to buildings, vehicles, construction projects, or goods in transit. SASRIA insures on a voluntary basis.

Austria	***Terrorpool-Oestereich.*** Set up in October 2002, Terrorpool-Oestereich is a terrorism pool covering all property damage and business interruption arising from terrorism up to a maximum limit of € 5 million per policy/location. The insured has the option to buy an additional € 20 million in coverage for an additional premium. About 99% of the primary insurers in the Austrian insurance association participate in the pool. Terrorism coverage in Austria is voluntary. Negotiations between the Austrian insurance market and the Minister of Finance regarding a state guarantee are currently ongoing.
Israel	Coverage for terror and war risks to property (but not business interruption) is granted under Israel's property tax law. Compensation is limited to real indemnity values, as opposed to the reinstatement compensation offered by insurers until 2002. Coverage for bodily injury and death caused by enemy acts of aggression (including terrorism) is provided by the Israeli government under the Insurance for Victims of Enemy Action program.

PREPARED STATEMENT OF JACQUES E. DUBOIS

CHAIRMAN AND CEO, SWISS RE AMERICA HOLDING

MAY 18, 2004

Good morning Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. My name is Jacques Dubois and I am Chairman and CEO of Swiss Re America Holding Corporation. We have filed written testimony for the record. Thank you for your leadership on this urgent matter and for giving us this opportunity to comment regarding the Terrorism Risk Insurance Act.

First, a few words about Swiss Re. Founded in Zurich, Switzerland in 1863, Swiss Re has insured risks in the United States since 1880. Today, Swiss Re has global revenues of approximately $28 billion and total assets of $130 billion. Swiss Re is the world's second largest reinsurer and the world's largest life and health reinsurer and is also North America's largest reinsurer. Our company insures risks globally, operating from 70 offices in 30 countries. We employ 2,300 people in the United States and 9,000 worldwide. We are also members of the Reinsurance Association of America and the American Council of Life Insurers.

More to the point of today's hearing, Swiss Re has responded to virtually every major U.S. catastrophe over the last 100 years. In fact, for Swiss Re, prior to September 11, our largest single loss relative to capital was the San Francisco earthquake in 1906. Swiss Re plays an important role in the U.S. insurance industry and is active in discussions regarding terrorism risk and terrorism losses. Our September 11 claims totalled $3.3 billion and we were the largest insurer of the World Trade Center.

Although reinsurance is not subject to TRIA, Swiss Re has a keen interest in the law for two reasons:

- First, U.S. terrorism risk stems, in large measure, from terrorists' efforts to influence government policy. Terrorist attacks seek to undermine U.S. institutions and culture. Prior to September 11, terrorism had not been perceived as a significant risk. But September 11 demonstrated the enormous potential for loss caused by terrorist attacks. We feel very strongly that Government must play a partnership role with the insurance industry in coping with these losses. Insurers, reinsurers, property owners, business owners, employees, and government and its institutions—all of us are at risk for terrorism.
- Second, in short, TRIA has worked. TRIA has provided protection to insurers that limits losses in the event of an additional terror attack. This has allowed insurers to perform their traditional roles in bearing risks against losses from perils that the industry can effectively price and underwrite such as hurricanes, floods, fire, auto accidents, and other events.

As a reinsurer, we are not required to provide terrorism reinsurance coverage. And, for the most part, we do not now provide terrorism reinsurance because we cannot quantify the frequency or severity of possible events. There are a few exceptions:

- We provide partial protection for clients in containing their TRIA retention exposure.
- We provide modest catastrophe cover for our group life clients.

In both cases, what we provide is a fraction of what our customers need and want and what we had provided prior to September 11.

What these two exceptions have in common is that we can quantify our maximum exposure. To accept risk without fully understanding our exposure would be irresponsible to our shareowners and to our customers.

The impossibility of predicting frequency and severity of terrorism attacks is the primary reason why the reinsurance market has been cautious in offering terrorism risk protection. Although much work has been done on models to assess terrorism risk, forecasts of the frequency, and the magnitude of terrorism losses are extremely problematic. Statistical data is simply unavailable to begin to quantify this risk. And we must accept the fact that it may never be possible to capture, in a model, the intentions of human minds that strive to inflict maximum devastation and human suffering.

Nevertheless, a limited reinsurance market for terrorism risk has developed. Insurers can buy some terrorism coverage for their TRIA retention. They must, however, retain a substantial amount of the risk. Covers are usually subject to limits per event as well as an annual aggregate limit. Further, most contracts have exclusions for events involving nuclear, radiological, biological, or chemical weapons. But, in total, the coverage available is insufficient even to cover TRIA's deductibles.

Swiss Re's position is that the insurance and reinsurance market is not currently prepared to absorb terrorism risk regardless of our limited improvements in our ability to assess risk. The attack on the WTC caused insured losses estimated at up to $40 billion including $21 billion in property and business interruption lines alone. Total insured and uninsured losses have been estimated at about $100 billion. Loss estimates from September 11 exceed the largest losses from natural catastrophes the industry has ever suffered: Hurricane Andrew 1992: $21 billion; Earthquake Northridge 1994: $17 billion; Winter storms in Europe 1999/2000: $9 billion.

Potential losses from a terrorism attack conceivably could be much larger than total insured losses of September 11 or the largest conceivable natural catastrophe loss. Swiss Re is currently co-sponsoring with nine other organizations a study by RAND Corporation aimed at assessing terrorism risk and loss potentials. Study results will be released over the next 2 years. In addition, Swiss Re assisted in another study by RMS, a leading risk modeling organization, which also analyzed terrorism scenarios. This study found that insured losses of $80 billion are possible for worker's compensation and life insurance lines of business. Further, LOMA, a research and education association for the life insurance and financial service industry, has also released a study on terrorist events such as a smallpox attack that could result in deaths in excess of 30 million. Just as with September 11, these losses have not been factored into insurance prices and cannot be absorbed within the industry's capacity.

This issue is extraordinarily complex. We know that if a major terrorism event were to occur, it would likely hit several insurance lines of business simultaneously, as illustrated by the WTC event. The September 11 tragedy caused insured losses in individual life, group life, aviation, property, business interruption, workers' compensation, and accidental death. In the light of these uncertainties, our cautious approach toward terrorism risk is dictated by our responsibility to our shareholders, clients and employees.

We urge you to pass a 2-year extension of TRIA. The extension will allow TRIA to continue to provide protection to the insurance and reinsurance industry as well as to provide additional time to assess terrorism risk.

Certain group life writers have petitioned for inclusion of group life insurance in TRIA. We support their petition. Adding group life to TRIA will provide group life insurers the protection they need to insure the lives of people in the workplace. Group life insurers are not free to manage their risk through terrorism exclusions. State regulators will not allow it. As a public policy matter, State regulators have decided that this basic insurance now covering 158 million Americans is vital. The regulators are right. Group life should be included in TRIA. In fact, Swiss Re believes that individual life insurance should also be included but we await the conclusions of the RAND Corporation and U.S. Treasury studies.

In closing, Congress should extend TRIA for an additional 2-year period. Swiss Re is committed to working with the Federal Government to develop solutions that involve all stakeholders. In the weeks and months following September 11, Swiss Re met with Members of Congress and the U.S. Treasury to discuss possible approaches to this challenge. We recommended that the Federal Government consider adopting the UK's working solution, Pool Re. Pool Re and other solutions should again be considered. We believe that a public-private partnership between the Federal Government, industry and insured parties is the best way to deal with the risks involved. We believe Government has an ongoing role and responsibility due to the relationship between Government policy and the motivations and actions of terrorists.

RESPONSE TO A WRITTEN QUESTION OF SENATOR SANTORUM FROM J. ROBERT HUNTER

Q.1. What is the rationale for excluding group life carriers from TRIA coverage? It is my understanding that State insurance commissioners do not allow group life carriers to exclude terrorism act coverage from these policies even though these outstanding contracts expose companies to billions of dollars in losses. If TRIA is to be extended, should serious consideration be given to including group life carriers in the program?

A.1. The rationale for excluding group life insurance coverage from TRIA is the same as the rationale the NAIC used in deciding to not allow exclusions for terrorism insurance; the industry does not need backup or exclusions.

The group life situation vis-á-vis terrorism risk is a classic example of a problem that the private sector can solve by itself without Government help. Here is why: A group life carrier might have an extreme exposure in a city, say Manhattan. Other insurers might have extreme exposures in other places, like Chicago, Los Angeles, Miami, Philadelphia, and so on. These insurers are free to pool these exposures with each other in a way to spread this risk across the industry and all over the country.

The NAIC wisely denied the request for terror exclusions from group life policies because the industry had not done due diligence to determine how to pool these risks to spread the risk and make exclusions unnecessary. The NAIC saw that a private sector solution was feasible and should be undertaken.

For the same reason, Congress should not step in to this situation, which can be easily dealt with privately.